

# The International Family Offices Journal

Editor: Nicola Saccardo

## Editorial

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## Family offices regulation in Hong Kong – navigating a growing landscape

William Ahern and Caine Ng

## The art of managing a collection – reflections from the family office perspective

Caroline Gillis, Agnès Le Ster and Marie-Thérèse Yates

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## Right on time – why Switzerland is poised to become a prime jurisdiction for families to establish their private trust companies

Dharshi Wijetunga, Sophie Hart and Olivier Cavadini

## News section

Selection from STEP News Digests

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ADVISING FAMILIES ACROSS GENERATIONS



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# Welcome to the 31st issue of The International Family Offices Journal

Nicola Saccardo

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I am delighted to introduce another fascinating issue, covering topics relevant to family offices and those they serve. As usual, there is a real breadth of articles included in this issue, which shows the great work being done in this area by practitioners and family office professionals.

The international context in which family offices operate is a particular theme of this issue, especially relevant given the turbulent current global outlook. William Ahern and Caine Ng open the issue with an overview of the outlook for Hong Kong, a market aiming to establish itself as a hub for family offices, but also compare the jurisdiction to its competitors in Asia, Singapore and Dubai. The global art market is a consideration for family offices not just in Asia but throughout the world, with an estimated annual turnover of £67.8 billion. Caroline Gilis, Agnès Le Ster and Marie-Thérèse Yates run through the practicalities and legal considerations to be kept in mind for family offices with substantial art collections, advising on a wide range of issues from climate-controlled warehouses to the qualities of a good art collections director.

Turning from the joys of life to the practicalities of it coming to an end, Kerri M Scott advocates carrying out a death audit to simulate the administrative complexities that follow the death of the wealth owner. Advance preparation can ensure that plans and structures are still appropriate and maximises the likelihood of a smooth transition. Dr Paul L Hokemeyer draws on his experience as a family therapist, writing an intriguing article on the nuances of working for and advising UHNW narcissists, dividing this

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category into the grandiose and the vulnerable. He provides a four-part strategy for how best to work with narcissist clients while maintaining professional integrity and personal self-care. Continuing the mental health theme, Emily Deane introduces STEP's Global Representative Power, a template for a power of attorney intended to function across multiple jurisdictions, which aims to reduce the administrative burden on clients at a time of particular vulnerability.

Returning to the international theme of this edition, Ola Adeosun and Valentina Tacchino address the anticipated transition of £5.5 trillion to future generations between 2020 and 2047 in increasingly internationally mobile families. They lay out some ways to structure strategic thinking and highlight some key issues in an international context. Moving from international dynamics to family dynamics, Amy Szostak and Stan Treger draw together reflections on navigating thorny family issues with clients. Family issues can dramatically change the trajectory of careful financial planning so their five-step process to reflect, share, align, engage and reassess provides a useful framework for supporting families at a difficult time in their lives.

Shabnam Shaikh and Pranav Doshi write from India, highlighting the benefits of the International Financial Services Centre in Gujarat, which boasts an investment scheme tailored for family offices: the family investment fund. This structure facilitates international investment and has a number of regulatory benefits which will be of interest to those linked to this fast-growing market. This may be of particular relevance for readers of Melvin A Warshaw and David Lesperance's overview of considerations for Americans seeking second residences and citizenships. They outline several potential advantages, while highlighting the need for careful consideration of US taxation and filing obligations.

Finally, Dharshi Wijetunga, Sophie Hart and Olivier Cavadini explore why Switzerland is poised to become a prime jurisdiction for families to establish their private trust companies. They explore the new regulatory environment for Swiss private trust companies and the potential they have to play a central role in international family wealth structures.

The articles are followed by our usual round-up of relevant highlights from the STEP News Digest.

# Leaving America: tax and immigration considerations for Americans obtaining second residences and citizenships

Melvin A Warshaw and David Lesperance

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As the world becomes increasingly interconnected, embracing the concept of acquiring a foreign residence or citizenship can prove to be instrumental in harnessing a range of global opportunities while fostering a sense of security and adaptability.

In this article, we will explore the reasons why high-net-worth (HNW) Americans may want to secure a second residence and/or citizenship and the different ways they can achieve this goal. In addition, we will explore the various tax issues arising from how they choose to use that second residence or citizenship.

## Americans protecting themselves against an uncertain future

The driving force for HNW Americans and their families acquiring a second residence and citizenship is their desire to be in a better position to harness global opportunities on the one hand, and growing concern about economic, political, social and environmental 'wildfire' risks on the other. These risks include new 'tax the rich' proposals, increased political polarisation resulting in violence and social unrest, the mass shooting epidemic and the increasing frequency and severity of natural disasters.

Increasingly our clients are turning to us to help them acquire the 'fire insurance' of a second residence and/or citizenship. This fire insurance is then integrated into a customised 'fire escape' plan which considers the tax and practical aspects of their unique

lives. Taken together, the fire insurance and fire escape constitute what we call 'backup plans' which fall into three categories:

- get out ... or go bag: this allows for instantaneous temporary relocation;
- American citizen living abroad: this is either a temporary or permanent relocation; and
- expatriation: this is a permanent and legal departure from the US tax system.

## Methods of acquiring a second residence

There are a variety of different types of foreign residence status that an American can organise as part of their backup plan: visitor, resident and citizen.

The simplest status is as a visitor in a foreign country. The first consideration for this status is whether the American needs to acquire a visa from the foreign country's embassy or consulate. Once they either have the visitor visa or determine that they can seek entry without a visa, then the American can attempt to enter that country. Possession of a visitor visa or having visa-free travel does not guarantee entry. The danger of relying on visitor status alone was dramatically demonstrated during the pandemic when Americans were blocked from visiting many countries including previously welcoming countries like Canada, the United Kingdom and other European countries. Another point is that even if granted visitor status, there are limits to the period of time that an American can remain in the foreign country. For the European Schengen states the limit is 90 days per annum. Other countries like Canada will allow 183 days.

The uncertainties inherent with relying on visitor status alone has driven many prudent Americans to seek greater status in their chosen destinations. These greater statuses begin with work or study permits, extend to annual or time limited residence, and end with permanent residence. These more privileged statuses can be acquired through:

- family sponsorship;
- education and employment qualifications;
- retirement;
- business expansion; or
- investment/government contribution (aka 'residence by investment' or 'golden visas').

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It is worth noting that while residence by investment and golden visas have garnered the most attention in the press and online, much of that attention is the result of over-blown concerns expressed by politicians and the media whenever there is a problem with one of the many good programmes, and the marketing hype and aggressive salesmanship by commission-driven organisations and salespeople.

In our many years of experience, the appropriate type and path to obtain a quality residence status in any country should only be determined *after* consulting with qualified and unconflicted advisers who have a good understanding of all the available programmes and options and who act only in the best interests of those seeking to acquire resident status.

### **Methods of acquiring second citizenship**

The United States is one of more than 60 countries that allow its citizens to hold citizenships of one or more other countries. Since most Americans only possess one additional citizenship, the common term to describe this situation is 'dual citizenship'. However, the more accurate description would be 'multiple citizenships', as some Americans possess two or more additional citizenships. Therefore, whether by birth, descent, naturalisation or investment, an American can hold two or more passports at once.

There are a number of ways that Americans can acquire one or more foreign citizenships. These include:

- birth in country (aka birthright citizenship or *jus soli*);
- parents foreign citizenship (aka *jus sanguinis*);
- lineage (aka citizenship by descent);
- religious affiliation (eg, Israeli law of return);
- naturalisation;
- investment/government donation (aka citizenship by investment or golden passports); and
- discretion of government.

Just as with residence by investment or golden visas, the appropriate type and path to obtaining a

second citizenship should only be determined *after* consulting with experienced and unconflicted advisers who are acting only in the best interests of those seeking to acquire the citizenship.

### **Benefits of second residence and/or citizenship**

Having an alternative residence permit or second citizenship can provide many benefits. It can give an individual more access to different countries and remain in that country for a longer period of time. Travel to and from both countries without the need of a visa or additional documentation can save time and money as well as reduce the stress of international travel. Dual residents/citizens may be eligible for benefits such as healthcare and education in a foreign country and have access to new opportunities for work and living arrangements.

### **Important tax considerations for Americans living abroad**

Living outside of the United States for extended periods of time offers a range of opportunities and benefits. However, it also comes with important considerations and responsibilities. Understanding the tax implications is crucial to navigating this journey successfully and this is where expert advisers can be invaluable.

### **US tax reporting obligations**

American citizens and residents (ie, green card holders) must report and pay US tax on their worldwide income, unless foreign source income is excluded from US income by virtue of an income tax treaty or a specific provision of the US tax code. However, tax treaties are not watertight. Most US tax treaties have a savings clause that reserves the right of the United States to tax its citizens regardless of any tax treaty. Furthermore, while such treaties attempt to eliminate double tax of the same income, the offset is at times imperfect.

In general, there are at least two tax reporting considerations for Americans who are living abroad. First, when an American opens and funds an overseas bank account they are very likely triggering two

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annual filing obligations with the United States. They must first disclose on Schedule B attached to their Form 1040 the country where they have a foreign bank account and correctly answer the question on Schedule B inquiring whether the highest daily balance of all their foreign accounts exceeds \$10,000 on any day during the tax year. If the account exceeds this threshold, they are also required to electronically file with FinCEN at the US Treasury Form 114 (FBAR). Failure to file an FBAR can result in very significant penalties.

Also, when Americans consider a citizenship by investment (CBI) or residency by investment (RBI) programme in a foreign country, they often do so by making an investment in an approved government or private fund. Unfortunately, many Americans fail to realise that such funds will be classified by the United States as a Passive Foreign Investment Company (PFIC). Most PFICs are pooled investments held through a foreign corporation outside the United States, and the US tax treatment of PFICs owned by Americans is quite punitive compared with that of similar investments made by Americans originating in the United States. Perhaps the most difficult feature of PFICs is the enormous US annual tax reporting obligation that comes with such investment.

A separate IRS Form 8621 must be filed annually for each separate underlying foreign investment fund that meets the definition of a PFIC. Sometimes a foreign account holds multiple different underlying investment funds requiring the filing of a separate Form 8621 annually for each separate fund. In fact, many US investment advisers and return preparers strongly urge Americans against owning foreign mutual funds and foreign private equity funds and encourage separate investments in specific foreign stocks to prevent the generally adverse PFIC reporting rules from applying. The need to comply with PFIC filing obligations often also triggers the obligation to file Form 8938 covering foreign financial assets.

In addition to complying with their annual FBAR and PFIC filing obligations, there are a host of highly technical US international information reporting forms and returns which an American must file. The most common mistake Americans who own more than 10% ownership in certain closely held private foreign corporations make is simply not filing Form 5471 applicable to certain 10% or more US shareholders. The Form 5471 must be filed based on shareholder ownership and the filing obligation and

includes officers and directors who must report on the shareholder ownership interests of certain US shareholders during the year. In general, the US shareholder required to file Form 5471 must include an income statement and balance sheet for the foreign corporation even if the company had no income. At worst, if the US person owns more than 50% of the stock in such foreign corporation the US shareholder will be subject to current US income tax on his or her share of most of the active business income and all of the investment income of the company.

If an American owns a specified ownership percentage in a foreign partnership or foreign limited liability company, there may be a default classification of such foreign entity for US tax purposes. Sometimes an American can elect a different US tax treatment for a foreign entity by filing an IRS Form 8832 with the IRS when they initially acquire their ownership interest in the foreign entity.

If an American owns a certain minimal ownership in a foreign disregarded entity, or certain interests in foreign tax owners of a foreign disregarded entity, then such individual may have to file IRS Form 8858.

If an American owns an ownership interest foreign partnership, or controls a foreign partnership, then such individual may have to file Form 8865.

Failing to report foreign income and assets can cost non-filing Americans very significant penalties. Many of those penalties may be assessed penalties by the IRS even when the amounts received are not taxable to the American, including receiving a gift or inheritance from a foreign relative or estate, or any distribution from a foreign trust. Gifts or inheritances received from a foreign person or estate in excess of \$100,000, and all distributions received from foreign trusts, must be reported by Americans on Form 3520 even though they do not trigger any US income.

#### *Different regulatory environment living outside the United States*

Americans living outside of the United States faced a difficult period after enactment of the Foreign Account Tax Compliance Act (FATCA) which was passed in 2010 and implemented from roughly 2010 to 2017. First, they found that the things they were able to do with their accounts were frequently limited or they had to sign a wide variety of new paperwork – either for their US accounts or their international ones. After this initial period of paperwork, things frequently got worse as their US or international

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accounts frequently sent them information informing them that their accounts would be closed or frozen within 30 days.

Such notifications came from major independent custodians (Charles Schwab, TD Ameritrade and others including Vanguard) or large brokerage houses (Morgan Stanley and Merrill Lynch have all recently closed accounts for Americans outside of the United States). FATCA caused many American brokerages to begin to pay attention to laws they had largely ignored, because FATCA suddenly gave the United States the tools to enforce these laws which had been hard to prosecute in the past.

While FATCA has had significant effects on individuals, it is actually a law on financial institutions and doesn't apply to individuals directly. The law requires all financial institutions worldwide to search through their current accounts and report the accounts they have that are owned by Americans. Should they fail to do so, the American government will withhold up to 30% on payments to these foreign financial institutions (FFIs) originating from within the United States.

Given the United States global position as the hub for a multitude of financial transactions, the harsh (some might say draconian) penalties meant that FFIs went into overtime in an attempt to comply with the law. For smaller banks and institutions, without the resources to ensure compliance, this meant they scoured their records and eliminated Americans who might subject them to FATCA penalties. For larger banks, this generally meant they eliminated smaller accounts, required further paperwork, or restricted the services offered to Americans.

While FATCA and its consequences explain why it has been so hard for Americans to open accounts in jurisdictions outside of the United States, they don't explain why Schwab, Merrill Lynch, TD Ameritrade, Vanguard or other companies have made it so hard to open accounts in the United States for Americans who live outside of the United States. The chief reason is anti-money laundering laws known informally as the 'know your client/customer' laws. The chief among these were passed in 2001 as part of the Patriot Act and were refined and clarified before being implemented in the following years though they serve as an updating of the 1970 Bank Secrecy Act.

Reporting is mandated on US persons. This broad

category includes US citizens, US residents, green card holders and trusts controlled by US persons. Foreign financial institutions are required to report directly to the IRS the name, address and account number of all clients deemed to be a US person. They must also report the highest daily account value in US dollars over the course of the year and inflows and outflows to the account.

Since 2011, the new IRS Form 8938 must be filed by all US persons if total foreign financial assets owned exceeds \$50,000 on the last day of the tax year or more than \$75,000 at any point during the year. For US persons residing outside the United States, the reporting thresholds are raised to \$200,000 and \$300,000, respectively.

#### ***US Securities and Exchange Commission (SEC)***

Regulation S of the SEC generally provides that the registration requirements of the Securities Act do not apply to offers and sales of securities if both the offer and sale occur outside the United States. Additionally, Regulation S requires that the issuer not offer or sell securities to US citizens or residents even if those persons purchase the securities abroad. Determining whether an offer or sale occurs outside the United States is a rather simple test – namely, whether the investor is physically located outside of the United States both at the time he or she is first solicited to purchase the securities and at the time he or she executes the subscription agreement or other contract to purchase those securities.

According to the SEC, a natural person is a resident of the country in which he or she permanently (not temporarily) resides. The SEC has indicated that a distinction should be made between persons permanently residing abroad and US residents who are temporarily abroad. US citizens and other persons permanently residing abroad who purchase securities may be deemed to have chosen foreign markets, and the laws and regulations applicable to those markets. US residents who are temporarily abroad, however, should be treated differently because they continue to maintain a permanent presence in the United States that warrants full protection under the federal securities laws.

Whether a person temporarily or permanently resides in the United States is a factual question that depends on the circumstances surrounding that

person's presence in the United States. Accordingly, to the extent an American resides permanently outside the United States, their custodian may insist that such American convert to their non-US investment platform which only sells Regulation S eligible investments.

***Residing in treaty countries – an advantage for green card holders***


In general, US citizens are neutral on whether or not they live in a treaty country. However, a vital threshold question is whether lawful permanent residents (ie, green card holders) will be living in a treaty country or not?

For certain green card holders who are living in a

tax treaty country and who have not held such visa status for more than seven years, they may have an opportunity to cease US tax residency before the eighth or later calendar year. Filing a Form 8833 Treaty Position claiming non-residency in the United States before the eighth calendar year holding such status may limit the green card holder's exposure for US exit and inheritance tax under the expatriation tax regime applicable to long-term green card holders. Once an individual lawful permanent resident has retained such status for more than seven tax years it is much more difficult to escape the US exit and inheritance tax systems should they decide to abandon their green card status.

This is an extract from the article 'Leaving America: tax and immigration considerations for Americans obtaining second residences and citizenships', by Melvin A Warshaw and David Lesperance, taken from the 31st issue of *The International Family Offices Journal*, published by Globe Law and Business, [www.globelawandbusiness.com/journals/the-international-family-offices-journal](http://www.globelawandbusiness.com/journals/the-international-family-offices-journal).





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