# HEADS I WIN, TAILS YOU LOSE: ADVISING THE WEALTHY IN TIMES OF PROTRACTED AND UNPRECEDENTED POLITICAL, ECONOMIC, CULTURAL AND SCIENTIFIC CHANGE

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## Summary

Observations on how difficult it has become to do estate planning and wealth preservation for clients when the rules change constantly. It covers tax changes here and abroad (as they impact one another), enforcement changes leading to new reporting requirements, changes in access to information, changes in the nature of families, and changes in the frequency of intra-family litigation, then reviews what changes are likely in transition, which will return to "normal," and which changes are here to stay -- and how best to advise in the meantime.

100 Introduction

100.1 We are all experiencing a truly unprecedented amount of change in all areas of life and all areas of the world. It is the impression of the rest of the world that much of the change originates from the United States and in this foisted upon the rest of the world, like it or not (though COVID19 may be a notable exception).

100.2 For centuries, the laws of trusts and estates were more or less immutable. Now, they not only change constantly, but they also change in the middle of the game, which until recently was never considered "fair." It is easy to point to the revolution in technology, but since the summer of 2008, the private client world was turned on its head by global events.

101 Issues Arising from Advising the Super-Rich

101.1 In recent years, a disproportionately large amount of wealth has ended up in the hands of a disproportionately small number of people around the world.

101.2 Their problems are of prodigious proportions, including:

A. Tax – rising rates and concerted enforcement efforts among countries

B. Political – turmoil both domestically and in jurisdictions in which they have business interests

C. Social – rapidly changing views of marriage, gender equality and family

D. Safety – increasing concerns for personal and physical security and protection of assets

E. Health – COVID19 and global pandemics

F. Conflicts of laws – evolving changes to the normal choice of law rules in international dealings

G. Succession – how and whether to attempt to keep family enterprises intact and profitable

H. Emotional – the super wealthy have problems just like everyone else, but a decreased lack of sympathy for them by others, given their wealth

I. Privacy – increased scrutiny, cyber breaches, and increasing challenges to reasonable expectations of privacy

J. Trusts under attack – viewed as a *per se* shams

102 Backdrop to Unprecedented Change

102.1 Since the summer of 2008, the world has seen:

A. World–wide recession

B. All asset categories have been affected

C. First time financial indices over a ten year period have been flat

D. The collapse of major investment houses, such as Bear Stearns and Lehman Brothers

E. The near collapse of global banks, but for massive government bailouts,

F. Accounting scandals involving large public companies, such as Enron, WorldCom, Olympus and Xerox, which is still ongoing

G. The discovery and collapse of Ponzi schemes, such as Madoff and Stanford

H. Political turmoil and change everywhere, including places where such change was unimaginable, such as the Arab Spring

I. The ongoing European debt crisis

J. The ongoing inability of US the Congress to pass responsible or timely legislation, sending the country over a "fiscal cliff" twice in three years, then into "sequester," and most recently with the temporary expiration of the entirety of the Patriot Act and the ability to combat terrorism.

K. COVID19 and the uncoordinated response thereto, both domestically and globally.

102.2 The rate, diversity and depth of change shows no signs of abating, certainly not any time soon.

103 Tax Optimization

How can we advise clients, when governments world-wide are now claiming after recession and pandemic related bailouts, given the ineffectiveness of, or at least shortfalls in, their tax collection systems, that taxpayers have a *moral* obligation to pay their *fair share* of tax?

103.1 Income vs. Transfer Taxes

It is useful to contrast income vs transfer taxes, and the revenue vs. social policies behind them, so that even if we don't know what the answers are, we can guess what the answers should be.

A. Income Taxes

Income taxes are paid by everyone. They have negligible nil bands or exemptions. Income taxes builds highways, bridges, tunnels, airports, dams, armies, etc. They are more revenue based than policy based (with certain notable exceptions, such as research and development, low income housing, etc.)

B. Estate, Gift and Generation-Skipping Taxes

1. Transfer taxes have no revenue policy. They account for less than 1% of the tax revenues of OECD countries. Rather, transfer taxes serve the social policy of redistributing wealth by doing desirable things – giving money to spouses and charities, either lifetime or at death, and making lifetime gifts to children.

2. It is not just Warren Buffet and Bill Gates who have campaigned in favor of transfer taxes. In the 1910's, Justice Louis Brandeis said, "We can have great concentration of wealth in the hands of a few, or we can have democracy, but we cannot have both." Also, in the 1910's, Andrew Carnegie (of Carnegie Hall fame) testified before Congress in favor of estate tax and anti-trust legislation.

103.2 Tax Evasion v. Tax Planning

A. It used to be that not paying one's income taxes was tax evasion and not paying one's transfer taxes was tax planning. Unfortunately, the distinctions are blurring as countries are desperate for revenues, forgetting the policies behind their various tax systems.

B. Planners have exacerbated the situation, as they have been supercharging trusts, to the point where they are now routinely attacked as *per se* shams in many parts of the world

1. Basic trust

The basic trust:

(i) prevented real property or transfer taxation as beneficial interest shifted from generation to generation

(ii) was domestic, so didn't avoid income taxes

(iii) lasted for up to, but no longer than, the applicable rule against perpetuities

(iv) was exempt only from beneficiaries' creditors

2. Modern trust

The modern trust:

(a) Can be exempt from income taxation if offshore and the applicable country taxes on a remittance basis

(b) Can be perpetual, as many jurisdictions have repealed their rule against perpetuities

(c) Can be exempt from one's *own* creditors, as many jurisdictions have repealed the Statute of Elizabeth

(d) Can provide beneficiaries with no rights to information, and in some instances with no knowledge that they are beneficiaries of a trust in the first place (or that a trust for their potential benefit even exists).

(e) Can provide numerous methods for the grantor to retain *de facto* control, such as with

- Directed trustees
- Protectors/Enforcers
- Purpose trusts
- Star/Vista trusts
- Executive entities
- Private Trust Companies

(f) Can repeal traditional conflict of law choices to apply local law, in order to defeat property or even marital rights

As a result, trusts are routinely ignored or pierced in many parts of the world, mainly for tax purposes but also for matrimonial, property, creditor and other purposes.

C. Injecting Business Doctrines into Personal Tax Planning – Problems with Alternatives to Limitations of Personal Trusts

1. In response to the increasing ineffectiveness of trusts around the world, practitioners are looking for entities to replace trusts. Many jurisdictions are enacting commercial foundation legislation, as they are similar to trusts, in the likely unrealistic hope that they will not be met with the same negative governmental and judicial response as trusts.

2. Other jurisdictions are looking to copy the American use of family limited partnerships and LLCs, without realizing that these entities have been abused by Americans in much the way that trusts have been abused by the rest of the world. Because partnerships and corporations are subject to business and commercial laws, not the donative laws of wills and trusts, they have been vulnerable to new and effective attacks by Internal Revenue Service, not otherwise applicable to wills and trusts, such as:

    - Lack of business purpose
    - Form over substance
    - Sham
    - Step transaction

3. Using business entities in lieu of trusts creates the additional vulnerability in that while there are professional corporate fiduciaries available to attend to the proper administration of trusts, most families run business entities on their own without professional guidance, causing problems in the administration of otherwise well drafted plans.

104 Increased Regulatory Response

104.1 The pendulum has swung too far in response to the financial crisis and attendant abuses

A. As a result, we are now confronting an end of secrecy, global information exchange and global tax enforcement/harmonization

B. Tax compliance is crucial, given that virtually every country is "broke"

1. The OECD and G20 have mandated information exchange agreements

2. FATCA and intergovernmental agreements are exploding across the globe -http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx

3. Followed by CRS – not Catholic Relief Services – Common Reporting Standard

4. The initial flight of capital to a less regulated Asia is slowing in response to increased scrutiny, such as the ICIJ investigation of Asian financial centers - http://www.icij.org/

5. FATF and the Global Forum have launched attacks on trusts, calling for their public registration world-wide - http://www.fatf-gafi.org/media/fatf/documents/reports/Misuse%20of%20Corporate%20Vehicles%20including%20Trusts%20and%20Company%20Services%20Providers.pdf

6. Governments choices are higher taxes or better enforcement or both. If taxpayers don't embrace better enforcement through compliance, then the results will not only be higher taxes, but also the loss of privacy along with the loss of secrecy.

104.2 Is it reasonable to expect that the pendulum will swing back, and if so, when?

105 Increased Private Client Litigation

105.1 There has been a world-wide explosion in the amount of private client litigation.

105.2 This is likely attributable to a number of factors, including:

A. Increasing popularity of the American Rule of legal fees, where generally one is responsible only for one's own legal fees, and not those of the prevailing party as well.

B. Increasing popularity of contingency fees, where generally one is not even responsible for one's own legal fees unless one wins.

C. People are living longer than ever, as a result of which their beneficiaries are waiting longer than ever to inherit

D. People are inheriting less than they expected, given the various financial crises.

E. Our own trusts and estates planning profession has contributed to the unpopularity of trusts by "pushing the envelope" with their traditional terms.

1. At its most basic, the trust is not usually viewed by the beneficiary as a vote of confidence by his parent or grandparent

2. A dynasty trust, with directed trustees and limited if any rights in the beneficiaries, becomes an instrument of torture.

F. Proliferation of Divorce and Changing Nature of the Family

1. It is said that one out of every two marriages end in divorce. Some think the rate is higher.

2. Besides divorce, however, there are new "challenges" to the traditional "nuclear family," such as:

(a) Same sex marriage

(b) Not marrying (i.e., living in "sin")

(c) Adult adoption

(d) Posthumous conception with frozen genetic material

106 Take Aways

106.1 We survived the various fiscal cliffs.

106.2 We survived the Mayan end of the world on 21 December 2012

106.3 The basic laws of physics have not changed.

106.4 We will be able to attend theatres and stadiums again.

106.5 What has changed?

A. Our tolerance of excess, however, has changed.

B. Our ability to tolerate change has also changed.

C. Computers and the internet make it possible to:

1. Keep up with ever faster change; it is no longer considered unfair to change the rules in the middle of the game, as it is considered an easy matter now to keep up.

2. Find out information about everyone and everything; there is no more hiding

3. Accessibility of BIG data.

C. Secrecy and information availability has changed.

D. Legislative, economic, political and social change is the new norm – expect it

106.6 What can be done?

A. Plan for change.

B. Plan for controversy

C. One size does not fit all – use customized solutions and a variety of vehicles/approaches

D. Where possible, keep it flexible.

E. Where possible, keep it simple.

F. Don't use structures for purposes for which they were not intended.

G. Where possible, be transparent – avoid surprise.

H. Stay inside the lines.

I. Tax laws and compliance will become more uniform.

J. The good news is that the wealth management industry and financial centers will now compete for positive, as opposed to negative, reasons, such as:

- Service
- Talent
- Legislation
- Economic stability
- Political stability
- Predictable and efficient judiciary

K. The playing field has been leveled, and there is plenty of opportunity for all.