# The Aver Advisory

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*presented by* Aver Associates *Estate Planners & Trustees* *contact@averassociates.com*

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## Taxation

### Spanish tax authority qualifies Malta tax refunds as dividends for tax treatment

*Spanish General Directorate of Taxes, Binding Decision CV3438-15*

The Spanish Tax Authority recently considered Spain's tax treatment of reimbursements received by shareholders of Maltese companies under Malta's tax refund scheme.

Malta employs a full imputation system of taxation which avoids the economic double taxation of corporate profits by imputing onto shareholders the underlying corporate tax attaching to dividends. Malta's system allows the shareholder to claim a full credit for any tax paid by the company on profits distributed as dividends.

Under the scheme, the shareholders of a Malta company are entitled to claim a refund of the Malta tax charged on profits allocated to the Malta Tax Account or the Foreign Income Account. The rate of tax refund depends on the nature of the underlying profits and the application of any double taxation relief by the Malta company on such profits.

In a 2015 binding decision, the Spanish General Directorate of Taxes held that such refunds qualify as dividends to which the Spanish participation exemption applies. Under Spain's participation exemption, dividends and capital gains are exempt from tax, if received by a Spanish entity that holds at least 5% of the share capital or equity of a foreign entity for a continuous period of at least one year.

In addition, the foreign entity paying the dividends must be subject to a tax comparable to the Spanish corporate income tax. This requirement is deemed to be met if the dividend-paying entity is resident in a country that has concluded a tax treaty with Spain, and such treaty contains an exchange of information clause. The foreign entity must also be resident in a country that is not a tax haven, and must derive at least 85% of its profits from business activities.

In light of the binding decision, corporate shareholders resident in Spain are no longer required to create a double tier structure in Malta in order to ensure that dividends paid out by the Maltese subsidiary benefit from the Spanish participation exemption regime. ■

### Citizens overwhelmingly support corporate tax rate reform in Switzerland

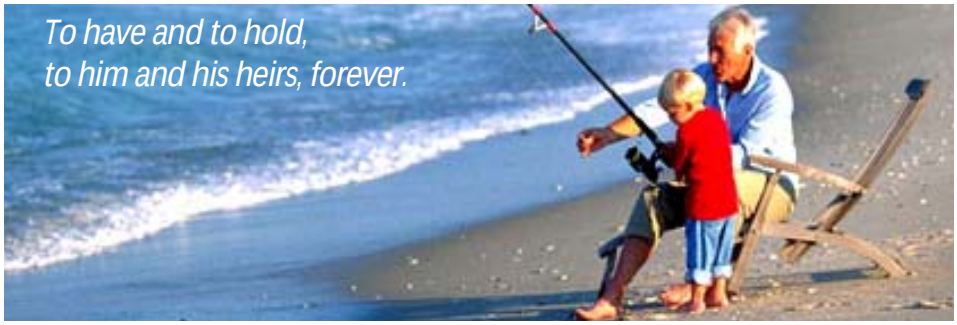
*Cantonal legislative referendum, Canton of Vaud, March 20, 2016*

Under pressure from the EU, Switzerland committed in July 2014 to abolish cantonal tax regimes. The Swiss government prepared the *Corporate Tax Reform III* with proposals to replace the abolished regimes by internationally accepted measures.

Considering the federal measures covered by CTR III as inadequate to maintain the canton's ability to attract companies with tax privileges, the Vaud legislative assembly approved proposals to lower the corporate income tax. The legislative amendments were challenged by the opposition, who launched a legislative referendum.

In March 2016, Vaud citizens overwhelmingly backed the reform, which calls for a significant reduction in the corporate tax rate from the current 22.33% to 13.79% by 2019.

In light of the reform, a company with headquarters in Lausanne, for example, will see its corporate income tax rate reduced significantly by 2019. ■



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# CLIENT CONTROL

**Recent decisions confirm *de facto* control as a means of attacking trust**

*JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev [2015] EWCA Civ 906 (February 27, 2015); JSC VTB Bank v Skurikhin & ors [2015] EWHC 2131 (July 21, 2015)*

Two recent decisions from the English courts have highlighted an emerging trend equating a settlor's *de facto* control of a trust or foundation with a legal right to the trust or foundation assets. The decisions emphasize the need for careful drafting and proper execution of trustee duties to ensure the robustness of a trust structure in the face of a court challenge.

## Pugachev case

**Facts.** Sergei Pugachev—the Russian oligarch who was once known as "Putin's banker" for his closeness to the Russian President—was sued for alleged misappropriation or embezzlement of bank finances. His worldwide assets were frozen by the London High Court as part of a civil case against him by the liquidators of his bank.

Pugachev's assets are held through five New Zealand-based trusts. Pugachev was one of a class of discretionary beneficiaries under the trusts. The issue of Pugachev's control over the trust assets would determine whether he could be ordered to provide information about the trusts.

Among the factors suggesting that the settlor retained some degree of control over the trust, and that he may therefore be treated as being beneficially entitled to the trust assets, are the following:

**i) Lack of trustee independence.** The trustees of the five trusts are all New Zealand corporations. New Zealand solicitor William Patterson is a director of each of the companies. Patterson's wife is also a director of two of the companies. The members of the boards of directors of all companies consist of three people: Patterson, his wife, and Russian lawyer Natalia Dozortseva, who is an associate of Pugachev. The shareholders of each company are Patterson and his wife.

**ii) Lack of protector independence.** While Pugachev used to be a protector of the trusts, he ceased to have that role but only after the grant of the freezing order. Patterson testified that this situation will remain "unless and until the freezing order is discharged".

**iii) Settlor's use of assets.** The house in which Pugachev lives in London is owned by a Manx company which is itself owned by one of the trusts. Pugachev apparently also admitted having "access to the trusts" for the purpose of doing business deals.

**iv) Circumstantial evidence.** In addition, a French chateau, which was Pugachev's holiday home, was held indirectly in the name of Pugachev's personal assistant.

**Decision.** In light of the above facts, the court found that formal ownership structures cannot simply be accepted at face value. It was noted that a settlor's assets may include assets held by a foreign trust, or a Liechtenstein foundation, when the settlor retains beneficial ownership or effective control of the assets.

The court applied a "good reason to suppose" test to weigh whether, on a balance of probabilities, the settlor had actual control of the trust assets. It was noted that trustees who conduct the affairs of a discretionary trust independently of a defendant whose only interest is as a discretionary or other beneficiary "could be expected to come forward with evidence to establish that the trust's assets were not under his control."

Pugachev's temporary resignation as protector was also significant. The court noted that the resignation does not exclude the possibility that Pugachev will resume the role of protector if and when the freezing order is discharged. Furthermore, the temporary relinquishment of those powers may in itself amount to an attempt to put assets beyond the reach of creditors, the court stated.

In light of the above, the court confirmed the worldwide freezing order finding that there was "a good arguable case that the assets held by the trusts are in reality assets of, or under the control of, Mr. Pugachev."

## Skurikhin case

**Facts.** Pavel Skurikhin is a Russian national and founder of a group of companies called the Siberian Agrarian Holding Group. VTB Bank obtained numerous final judgments from the Russian courts following the failure of Skurikhin to pay out under personal guarantees he had given as security for loans made by the bank to companies of which Skurikhin was chairman.

The bank argued that Skurikhin was the true beneficial owner of certain valuable Italian properties owned by a Liechtenstein foundation of which Skurikhin is a discretionary beneficiary. VTB Bank applied to the court to have the Italian properties included in a worldwide freezing order over Skurikhin's assets.

In related proceedings, Skurikhin was found to be in contempt of court over his reluctance to disclose documents relating to his possible control over the foundation.

**Decision.** The court relied heavily on circumstantial evidence, noting that Skurikhin had not contended either in evidence or in correspondence that he did not have the pertinent documents in his control. Consequently, the court proceeded on the basis that the disclosure sought is within Skurikhin's control.

The court concluded that the absence of any assertion by Skurikhin that the disclosure sought was not within his control was significant and gives rise to an inference that his role in the foundation consists of more than a mere discretionary beneficiary. If he were nothing more than a discretionary beneficiary, such documentation might well not be in his control, the court stated.

In the court's opinion, circumstances strongly suggested that Skurikhin controlled the foundation and that attempts have been made to render his personal assets judgment proof. As the risk of dissipation remained, the court considered it just and equitable to enforce the worldwide freezing orders in Italy. ■

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# Celebrity Estates

**David Bowie's trusts**

Pop idol David Bowie, whose real name was David Robert Jones, passed away in January of this year at age 69. His financial empire is estimated to be in the neighborhood of $100 million.

Bowie married Somali fashion model and actress Iman in 1992, with whom he had one child Alexandria Zahra Jones (Lexi), who was born in August 2000. He has one child from a previous marriage, Duncan Jones, who was born in May 1971. Imam also has one child from her previous marriage.

Bowie left the bulk of his estate 50% in trust for Iman, 25% to Duncan (not in trust), and 25% in trust for Lexi. Under the terms of his wife's trust, Iman is entitled to all of the income of her trust. In addition, the trustee may distribute all the trust assets to Iman for her health, education, maintenance and support.

Upon Iman's death, the balance of the trust, goes 50% to Duncan (not in trust)—if he survives Iman, or if not then to his children (not in trust)—and 50% to Lexi, in trust to age 25, if she survives Iman, or if not then to her children (not in trust).

In regard to Lexi, the trustee has discretion to distribute the income and the trust assets to her, or to accumulate the income, until she reaches age 21. Lexi receives all of the income of the trust beginning at age 21. When Lexi reaches age 25, the trust ends and she receives all of the trust assets. If Lexi dies before age 25, the balance of the trust goes to Bowie's then living children (not in trust).

While the two trusts are relatively simple, they are lacking in available estate tax and asset protection features. For example, they place the trust assets into Duncan's and Lexi's estates (in Lexi's case if she lives to age 25) for estate tax purposes, thereby exposing their inheritances to their creditors and spouses.

**Decanting the trust.** It may have been better for Bowie's estate planners to draft the trust as a trust for an undetermined period so that multiple generations in the future would receive creditor, divorce and bankruptcy protection, as well as protection from estate taxes.

The trust is governed by the laws of New York and the trust agreement allows the trustee to exercise discretion over the full trust assets. As such, there is an opportunity for the trustee to distribute all of the trust assets to two new trusts that will better meet the clients' needs, so long as the remainder beneficiaries remain the same.

New York was the first state to enact a so-called decanting statute, in 1992. If the trustee decants Iman's trust, the new trust can provide that after Iman's death, the balance of the trust will be divided into separate trusts for Duncan and Lexi. Likewise, by decanting Lexi's trust, the trustee can eliminate the requirement that the trust end when Lexi reaches age 25. ■

# Information Sharing

**Long-awaited Treasury regulations reserve unique space for trusts in the U.S.**

Earlier this month of May, the U.S. Treasury announced its long-awaited final rule on customer due diligence (CDD) procedures, requiring U.S. financial institutions to identify the beneficial owners of their corporate clients and to pass such information on to law enforcement agencies.

The CDD rule requires financial institutions to identify and verify the identity of any individual who owns 25% or more of a legal entity, and any individual who controls the legal entity.

As well as placing these new obligations on financial institutions, the rule also amends the existing *Bank Secrecy Act* regulations. The regulations will require financial institutions to gather beneficial ownership information on the substantial owners of, and the individuals that control, a legal entity when the entity seeks to open a bank or other financial account.

Unlike the laws that will be enacted in Europe to comply with the EU *Anti-Money Laundering Directive*, the regulations do not create national registries of beneficial ownership information for corporations and trusts.

Also unlike in Europe, private trusts are not included in the definition of "legal entity customer" under the regulations. Therefore, a trustee opening a bank account for a trust will not be required to provide the bank with information on the trust's individual beneficiaries.

In the Preamble to the regulations, it is stated that identifying a beneficial owner of a trust "would not be possible" given the unique space that private trusts occupy in the American legal system, and the legal relationship between the settlor, trustees and beneficiaries. Additionally, for entities with multiple layers of entity owners, the regulations state that a bank is permitted to "stop" looking through legal entities when it reaches a trustee, "if a trust owns directly or indirectly . . . 25% or more of the equity interests of a legal entity customer, the beneficial owner. . . shall mean the trustee."

Finally, noteworthy as well as it pertains to law firm practice, the Treasury confirmed that, for purposes of these regulations, the legal entity customer for an attorney escrow account is the lawyer or the law firm, and not the lawyer or law firm's clients, meaning that lawyers will not need to provide information to banks on their clients who have funds deposited in their client escrow accounts. ■