Way of the Dragon

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Despite the increasing costs associated with heightened regulation and transparency, offshore jurisdictions continue to prove popular with Asian clients. Kate Hodson and Lara Mardell explain why...

What is the issue? How Asian attitudes towards estate planning are evolving with regards to transparency

What does it mean for me? A recent report says that some of the biggest future challenges for wealth advisors in Asia Pacific in the coming years will include 'potential family conflicts during succession planning, a general aversion to discussing the details of wealth transfers, and worries about the ability of the next generation to manage wealth'.

What can I take away? An understanding of why Asian clients continue to structure their affairs through offshore jurisdictions

The call for increased global transparency has gained momentum since the Mossack Fonseca leak, but transparency initiatives have been in place for years.

Offshore jurisdictions such as Guernsey, Jersey, the BVI and the Cayman Islands have been taking strides to meet, and in some cases exceed, international transparency standards for many years. Each of these jurisdictions adheres to anti-money laundering standards set by the OECD and

Financial Action Task Force and are part of a network of tax information exchange agreements (TIEAs). In addition, they were early adopters of the *Foreign Account Tax Compliance Act* (FATCA) and the Common Reporting Standard (CRS), providing for the automatic exchange of information between signatory jurisdictions.

There has traditionally been some reluctance among clients in Asia to disclose details of their wealth. History is no doubt a factor; the appropriation of assets in China during the Cultural Revolution, for example, has more than likely contributed to a culture where people tend to be secretive about what they own.

Today, privacy and secrecy around details of wealth are driven by a number of factors including, at the extreme end, fear of attack. The Chinese equivalent of the Forbes Rich List, published in a magazine called *Hurun*, is known as the 'sha zhu bang' – the 'kill pigs list'. In other Asian countries wealthy individuals fear threats in other forms, such as kidnap.

Despite a desire for privacy, it is accepted that using offshore structures rarely achieves absolute confidentiality. Given the need to interact with institutions that carry out due diligence on their clients and the disclosures required under FATCA and CRS, confidentiality is now rarely cited as a reason to use these offshore centres. In Asia, offshore jurisdictions remain popular. A key reason for this is because these laws offer certain structures that are not always available under the laws of traditional onshore jurisdictions, and these options are often very helpful in achieving the aims of clients in Asia. .

Succession planning

In Asia, one of the key drivers behind wealth structuring is business succession planning, particularly in the context of family businesses. The transition of a family business from the founder to the next generation is a critical time. If shares in a family company are divided between children or other family members, the new shareholders may disagree on how the business is to be run, risking disruption and failure of the business.

If the shares are instead transferred to a family trust this risk is greatly reduced as a trust separates economic benefit from control. . This benefit will be achieved whether a traditional common law or the law of an offshore jurisdiction is the law of the trust, and in many circumstances an onshore law trust will meet the client's needs. However, many of the traditional laws have limitations in certain situations, such as when the trust fund consists of shares in the family company.

Under traditional laws the trustee has a duty to invest the trust fund sensibly and for the benefit of the beneficiaries of the trust. Where the trustee owns a company it needs to oversee the operation of that company and may be required to sell the shares in that company. This is clearly not appropriate where the company in question is the family business.

Jersey, Guernsey and Cayman have responded to this problem with the reserved powers trust, where the settlors can reserve to themselves or to certain other individuals powers that a trustee would usually have, including the power to invest or to direct investments. The trust deed could be drafted so that the trustee would not only have no duty to invest, but would have no power to do so. Consequently, the trustee would be prohibited from intervening in the operation of a company owned as part of the trust fund (absent extreme situations, such as criminal activity, and subject to the terms of the specific trust deed).

Importantly, the law of the trust (Jersey, Guernsey or Cayman, as the case may be) specifically states that where the settlor (or other named party) has power to invest, or to direct investment, then where the trustee acts in accordance with this instruction, it will not be liable for losses incurred as a result.

In principle, a trust written in accordance with a traditional law, such as England, could be drafted to hold a family company, with a reserved power of investment in relation to that company. However, without the statutory framework behind this, and in particular the exclusion of liability, such a trust may be perceived as too risky for a professional trustee.

The BVI's solution to the family company issue is the BVI VISTA trust. In this trust structure, the directors of the company owned as part of the trust fund continue to run that company without interference from the trustee (again, absent extreme situations and subject to the terms of the trust deed).

Reserved powers trusts and BVI VISTA trusts are also useful in the lead up to an IPO and are commonly used in this context where it would be undesirable for the trustee to have the power to decide whether or when to list a company. Another common use of these trusts is to enable a settlor to retain control over investment or the appointment of investment advisor. In our experience, the majority of settlors in Asia wish to retain such a power, even where the underlying assets are not trading companies, but simply investments.

Philanthropy

With increasing wealth levels and relatively low taxes in many Asian jurisdictions, clients are often interested in including some philanthropy in their structuring. Frequently this simply consists of naming a charity as a beneficiary in a trust, but in some cases individuals wish to set up their own organisation to further a specific cause.

An option offered by traditional and offshore jurisdictions alike is a trust set up for charitable purposes. This often has the advantage that it will offer tax benefits in the settlor's home jurisdiction. However, to qualify as 'charitable' the purposes for which the trust is established, and the activities the organisation undertakes, will need to satisfy a very specific and narrow definition. If the purposes are philanthropic but do not qualify as charitable, then under a traditional law the trust risks being invalid. The reason behind this is enforceability: a trust for

beneficiaries can be enforced by the beneficiaries and a charitable trust will have a specific body to enforce it (for example, in England this is the Charity Commission, and in Hong Kong the Inland Revenue).

However, the laws of Jersey, Guernsey, BVI and Cayman permit a trust to be created for non-charitable purposes (in Cayman this is known as a STAR trust – after the Special Trusts Alternative Regime). The laws get around the enforcement issue by requiring an 'enforcer' to be in place to ensure the trustee carries out the purposes.

Jersey and Guernsey also offer a corporate structure known as a foundation. This can be established for beneficiaries or for purposes. A foundation is controlled by a 'council', on which the founder can be a member, so is a helpful option for clients in Asia who often wish to maintain some control over their structure.

Private funds

In 2015 it was estimated that almost 70 per cent of Asia-Pacific-based hedge funds were domiciled in Cayman. Cayman is also the most commonly used jurisdiction for establishing private equity funds managed from Asia.

Funds that are domiciled in Cayman can be structured as an exempted limited company, unit trust or limited partnership. In addition, a new form of entity, the limited liability company (LLC), will soon be available adding to the range of flexible vehicles that can be used for structuring investment funds.

Countries such as Hong Kong and Singapore do not have such a flexible regime and currently it is not possible to establish an open-ended fund as a company in these jurisdictions. Although the rules on this are due to change, the suitability of these new regimes for private funds is not yet proven.

Crucially, the Cayman Islands offers fiscal neutrality. This is an important element for the cross-border nature of many investment funds, where investors (and fund assets) may be spread across a number of jurisdictions. It avoids any prejudice to one or more investors which might arise if the fund had been established onshore.

Cayman has put in place stringent AML regulations requiring due diligence on investors holding a 10 per cent or more interest in a Cayman entity. This is a stricter requirement than many onshore jurisdictions. As an early adopter of FATCA and CRS, the ongoing due diligence and reporting requirements under these rules are already well integrated into the operation of Cayman funds.

Summary

Despite the increasing costs associated with heightened regulation and transparency, demand for

offshore structures remains high in Asia. It is generally accepted that transparency is the way of the world and clients have adapted. Ultimately it is the structuring and legal solutions that these jurisdictions are able to provide that makes them so popular amongst clients in Asia and for this reason we expect their popularity to continue.

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