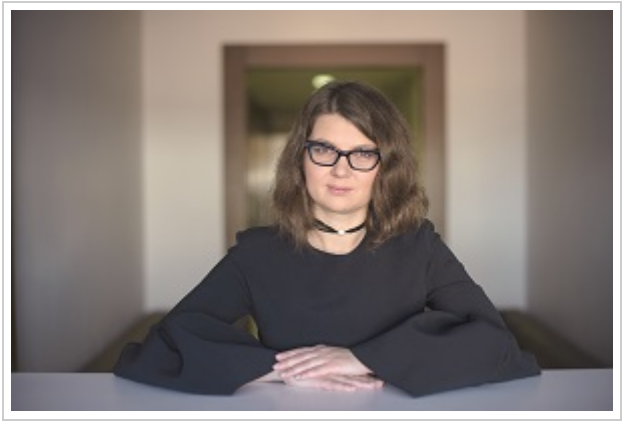
Cover Story (#01-02 January-February 2017)

Wanted Disclosed or Closed



Until recently private clients practice was not a very popular area of legal services in Ukraine. However, in recent years business owners have begun to realize the need for separation of their assets and the assets of their companies and the need to structure assets in the light of the trend towards global information exchange. The world is moving toward transparency and the main issue that remains is how to disclose the information in a proper manner. The rules of the game are rapidly changing, and management of private wealth faces revelations and disclosure threats.

We asked **Alina Plyushch**, counsel with **Sayenko Kharenko** law firm, to share with us the latest tendencies in private clients practice, outline the services in demand and expected developments in 2017.

UJBL: Could you please tell us what the past year of 2016 was like for private clients practice?

Alina Plyushch: 2016 marked the beginning of the end of traditional ways of holding and managing private wealth. The revelations in the so-called "Panama Papers" were the trigger which forced majority of asset managers and service providers to realise that this time the regulators have serious intentions. An unprecedented volume of information on owners of offshore companies (including well-known public persons misusing offshore structures) was made public, which caused all major regulators to implement ownership disclosure rules.

In addition to the traditional scope of services provided by our practice (creating trusts, foundations, investment vehicles and helping in structuring personal and family assets) in 2016 we saw an increase in demand for new services such as creating structures designed to

shield ultimate beneficial ownership (UBO) information, disclosing the information in a proper manner, choosing the most suitable jurisdiction for the specific aims of a particular UBO.

Besides, our clients continue to set up arrangements which aim to ensure the wellbeing of their wives, children and other relatives in case of the client's death or incapacity. Many wealthy clients are also interested in creating special funds to ensure the future of their children. After all, parents want to be sure that their children will obtain a proper education and not spend money earned by them in a useless manner. The establishment of such funds is one of the most widely spread services that private clients practice continues to provide to its clients.

Among others, our practice advice on issues connected with disclosure of UBOs, which became particularly topical as of today, taking into consideration world tendencies of international information exchange (which includes information on such UBOs) and introduction of state registers which disclose detailed information on UBOs.

UJBL: Has the profile of your clients changed in 2016?

A. P.: 2016 has brought us some new clients, particularly publicly exposed persons (PEPs) who are interested in questions related to the introduction of the electronic income declaration system.

Another category of clients is owners of large, medium and small businesses. They want their children to study abroad, to have the opportunity to buy property and perhaps obtain a foreign residency permit. We help them with all these issues.

Previously an average client supported the idea that his business is himself and all the personal assets were kept in the structure of the business. But now clients are trying not to affiliate their business with personal assets to avoid possible risks. Historically we had clients whose houses, cars and other personal assets have been held by their company, then the company was sued, property was frozen and clients lost all their possessions. It could have been avoided if everything had been structured in the proper way.

UJBL: You mentioned UBO registers. Could you please point out some key issues relating to the introduction of such registers?

A. P.: Introduction of the UBOs register may be a real threat to the privacy of beneficiaries. Directive 849/2015 of the European Parliament and of the Council dated 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (Directive) imposed obligations on member states to establish and keep updated national registers of beneficiaries of companies and trusts. Pursuant to the Directive shareholders with an interest in excess of 25% in a legal entity shall appear in national databases. Furthermore, a person who exercises effective control over the entity may also be shown as a beneficiary even though there is no direct or indirect interest of such person in the entity. The trustees of any express trusts created in accordance with the laws of member states will have to disclose information on the settlor, trustee, beneficiaries, protector and other persons who have influence over the trust.

UJBL: Who will have access to such registers?

A. P.: EU member states may create open-for-all online databases or provide limited access to certain categories of users. In all cases the information on beneficial ownership will be accessible to:

1. Competent authorities and so-called Financial Intelligence Units, without any restriction;

2. Credit and financial institutions, notaries and other legal professionals, auditors and tax advisers, within the framework of customer due diligence;

3. Any person or organisation that can demonstrate a legitimate interest.

These persons or organisations shall have access to at least the name, the month and year of birth, the nationality and the country of residence of the beneficial owner as well as the nature and extent of the beneficial interest held.

It remains to be seen how these registers would work in practice.

UJBL: Are there any countries which have already introduced the UBOs registers?

A. P.: The UK was the first country in the EU to introduce the register of companies' UBOs. According to the *Register of People with Significant Control (PSC) Regulations 2016* companies and LLPs incorporated in the UK are required to keep a register of beneficial ownership (PSC Register). From 30 June 2016 companies and LLPs are required to include information on PSCs into their annual returns/confirmation statements. Numerous safeguards were introduced to protect the information of personal shareholders. Currently, companies shall not disclose UBOs' residential addresses and their dates of birth. Only national authorities and, in very limited circumstances, credit reference agencies may obtain all information about UBOs.

The widely discussed Brexit has caused concerns on whether the UK will continue to provide access to the PSC register for the EU authorities. Furthermore, neither the EU Directive nor its related documents define "legitimate interest", which seems to be a key condition for coherent implementation of the Directive. Needless to say that the vast majority of financial and legal practitioners do not have sufficient knowledge about the upcoming changes.

France was another country to introduce such a register. The French model allowed a substantial level of disclosure where *inter alia* the public had access to personal information on UBOs (such as residential address). A similar approach was implemented in Ukraine. Issues arising from that approach have been recently tried in French courts. Initially the French Trust Register contained information about trusts connected with French residents and provided access for the tax authorities. However, in early July 2016 the French Government decided to go further and created a register containing details of persons connected to trusts. The compiled information was made public.

UJBL: Does the fact that personal information is contained in such register meet the fundamental principles of personal data protection and the right to privacy?

A. P.: It's quite an interesting and sensitive issue. This may result in possible breaches of privacy and data protection laws and, specifically, provisions of the *European Convention on Human Rights*. Moreover, European courts already have some precedents on this topic. The Supreme Constitutional Court of France, having considered the situation on 26 October 2016, ruled that the trust register is unconstitutional.

Ukraine may also encounter such problems since the Ukrainian UBOs register contains such personal information as addresses and dates of birth.

UJBL: And what is the situation with the registers in other EU countries?

A. P.: European institutions expect EU member states to create registers of beneficiaries by the end of June 2017. Although the Directive is not still fully implemented, new draft amendments to the Directive appeared in July 2016. The idea behind such amendments has a lot in common with the CRS. Following implementation of the proposed amendments the competent authorities of EU member states shall provide access to their registers not only to national organisations but to the Financial Intelligence Units of other member states. The draft is now being under approval of the EU institutions and committees and may come into effect in 2017.

UJBL: What tendencies do you see in private clients for 2017?

A. P.: The most expected issue in 2017 is the Common Reporting Standard (CRS). The upcoming launch of automatic exchange of tax information along with the European Union (EU) anti-money laundering initiatives seek to deprive private clients structuring their "private" component. With the CRS and Anti-Money Laundering Regulation, the Organisation for Economic Cooperation and Development (OECD) and the EU seem to become the major game changers in the private clients sector.

UJBL: What is the CRS?

A. P.: The CRS is a standard of exchange of tax information which defines the means and rules of automatic tax information exchange between participating jurisdictions. Investment accounts managed through financial institutions outside of the country of residence and vast amounts of money kept untaxed offshore stimulated the development of the CRS by the OECD. Since offshore tax evasion is becoming a more and more seminal topic in many jurisdictions it was agreed that priority should be given to efforts to make automatic exchange really global. The aim of the CRS is to allow participating jurisdictions to obtain financial information from their financial institutions and automatically exchange that information with other participating jurisdictions on an annual basis.

UJBL: What aims lie behind the CRS?

A. P.: The OECD states its core target of the CRS to be the fight against tax base erosion and tax avoidance, which usually include the use of tax heavens and offshore structures. In practice, wider implementation of the CRS by key jurisdictions should boost tax collections in participating jurisdictions by depriving beneficiaries of offshore structures of the habitual level of privacy *vis-à-vis* their states of residency.

The mechanism of the CRS is based on the well-known US FATCA (*Foreign Account Tax Compliance Act*) regime. Basically, both documents remain similar in many aspects except for the truly universal character of the OECD's solution. For instance, 106 jurisdictions have already committed to participate in the CRS by 2018, 54 of which are ready to start exchange for the 2017 tax year. Among these "early adopters" are Bermuda, the BVI, the Cayman

Islands and many other popular offshore jurisdictions which are expected to make their first exchanges in 2018.

UJBL: What information is subject to automatic exchange?

A. P.: Financial information to be reported includes all types of investment income (including interest, dividends, income from certain insurance contracts and other similar types of income) and account balances and proceeds from the disposal of financial assets.

Financial institutions which are required to report under the CRS include banks, custodians and other financial institutions such as brokers, certain collective investment vehicles, certain insurance companies and certain professional trust service providers.

Reportable accounts include accounts held by individuals and entities (including companies, trusts and foundations). The CRS requires looking through passive entities to report on the individuals that ultimately control these entities.

When the case involves trusts, information about the date and place of birth of the settlor, trustee, beneficiaries, protector and other persons who may exercise influence over the trust shall be exchanged as well.

Banks, trustees and other reporting financial institutions will collect this information and send it to the competent national revenue authority. Finally, the revenue authorities will transmit the collected information to the appropriate authorities in other participating jurisdictions.

UJBL: And what about Ukraine? Has it committed itself to participate in the automatic exchange of information?

A. P.: Ukraine has not yet committed itself to participate in the CRS, so technically information on Ukrainian UBOs of foreign entities will (at least in the near future) not be available to the State Fiscal Service of Ukraine. However, it is hardly unlikely that this *status quo* will be maintained for long. The President and the National Bank of Ukraine have recently endorsed Ukrainian participation in the CRS. Several draft laws on its implementation into the *Tax Code* were prepared in 2016. It is clear now that the EU's de-offshorisation is in line with international pressure from the G20 countries and will inevitably force Ukraine to adopt the standard.

UJBL: What trends in private clients do you foresee in 2017?

A. P.: To sum up, it has never been so important for advisers to give balanced and considered advice to families on how to structure their arrangements best, not just in view of prevailing family circumstances and tax considerations, but also with an understanding that the information on holding structures will be subject to greater regulatory, government and potentially public scrutiny in the near future.

In practice, existing trusts and entities are no longer safe mechanisms to shield a UBO's identity behind a chain of companies as major conventional jurisdictions have already committed to collect and transfer required personal data to the tax authorities of a UBO's residency. Whether it is "an unprecedented crackdown on personal privacy" for some or "the globally acceptable idea to decrease secrecy" for others, it may no longer be possible to hide

oneself behind offshore walls. The end of the “Private & Confidential” age is a new reality, which is as inevitable as death and taxes.