

The International Family Offices Journal

Editor: Barbara R Hauser

Editorial

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Reframing succession in a disruptive era – a business family perspective

Roger King and Jeremy Cheng

A tale of three families – passing on a treasured home to the next generation

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David Werdiger

A reflection on the art and practice of ritual within a family governance system

James E Hughes, Jr

Covid-19 impact on family office risk management strategies

Pete Shanley and Eric Powell

The GDPR for English law trusts and estates

Emma Haley

International private wealth clients in Spain – a quick post-Covid outlook

Patricia García Mediero

The next generation of strategic cultural philanthropy – impact, social justice and the opportunities for nextgen donors in the arts

Melissa Cowley Wolf

The phantom of Sutton Place – art collectors visible and invisible

Ronald Varney

Luxury Corner

Namibian diamonds – treasures from the deep

Laurie Wickwire

Media Review

Was the Union saved? Will the Union be saved? Grant, Lincoln and the national family

Eugene Lipitz

On Wealth

Competency challenges for the family enterprise

Lee Hausner

News section

Selection from STEP News Digests

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Contents

Volume 5, Issue 2, December 2020

Editorial _____ 3 Barbara R Hauser	The next generation of strategic cultural philanthropy – impact, social justice and the opportunities for nextgen donors in the arts _____ 38 Melissa Cowley Wolf
Reframing succession in a disruptive era – a business family perspective _____ 6 Roger King and Jeremy Cheng	The phantom of Sutton Place – art collectors visible and invisible _____ 46 Ronald Varney
A tale of three families – passing on a treasured home to the next generation _____ 12 Daniel M FitzPatrick	Luxury Corner _____ 53 Namibian diamonds – treasures from the deep Laurie Wickwire
Stress tests – building resilience in the face of a crisis _____ 16 David Werdiger	Media Review _____ 56 Was the Union saved? Will the Union be saved? Grant, Lincoln and the national family Eugene Lipitz
A reflection on the art and practice of ritual within a family governance system _____ 22 James E Hughes, Jr	On Wealth _____ 59 Competency challenges for the family enterprise Lee Hausner
Covid-19 impact on family office risk management strategies _____ 25 Pete Shanley and Eric Powell	News section _____ 61 Selection from STEP News Digests
The GDPR for English law trusts and estates _____ 31 Emma Haley	
International private wealth clients in Spain – a quick post-Covid outlook _____ 36 Patricia García Mediero	

Welcome to the December 2020 issue of The International Family Offices Journal

Barbara R Hauser, Editor-in-Chief

Again, continuing thanks for all the positive feedback on our Journal. Remember this is for the entire family office community – we solicit contributions and comments! As the word continues to spread, we enjoy receiving offers to write for us. We are already starting to fill the March 2021 issue.

A sad note

Our colleague Suzy Peterfriend, co-author of *Mommy are we rich?*, has passed away. We will miss her sparkle, her kindness and her deep understanding of all the family wealth issues.

The focus of the Journal

We feature articles from leading experts in the field, on a range of topics including the variety of family office models and structures, governance, investment approaches, succession planning, charity projects, family communication and consensus, and next generation issues among others. A key feature of the Journal is its international approach. We value our independence and our commitment to offering content without any conflicts of interest.

In addition to heavyweight substantive articles, we regularly feature in-depth country reports, profiles of family offices, interviews with industry leaders, a luxury corner, technology tips, book or film reviews, relevant news alerts from the Society of Trust and Estate Practitioners (STEP), and reflections by those who have grown up with wealth or advise those who have done so and what it has meant to them or their clients.

In this issue we are proud to include another fascinating variety of in-depth articles. We hope you enjoy them! This year with the pandemic has been difficult for so many – we are hoping for brighter times ahead.

We lead with a new look at succession planning, from Hong Kong authors Roger King and Jeremy Cheng. Their article title refers to our unsettled times: “Reframing succession in a disruptive era – a business family perspective”. The authors are concerned that the traditional views of succession – as in to whom the baton should be passed – are not sufficient for success in these changing times. They say they will

“demystify what a true family legacy means, which should not be the business per se, but the family’s entrepreneurial DNAs, shared identity and values, and an enduring pool of resources”. Overall, they argue that the necessary evolution is from being a ‘family business’ to being a ‘business family’. The article is carefully researched and contains a wealth of advice – including advice on expanding the role of a family office:

We believe that with a much-needed ‘upgrade’ in their functionalities, family offices can catalyse the transition from a family business to a business family and enhance the odds of successful succession. While families set up their family offices primarily as a one-stop shop for wealth management, they should also embrace governance, education and social functions.

Next, we have a great planning piece by Daniel FitzPatrick (United States) who tackles the perennial global conundrum of how to pass on a special family estate or compound. With wide experience which includes heading a global trust company, Dan has seen what works and what doesn’t. In this article, he looks at three cases of passing on the family special property. In “A tale of three families – passing on a treasured home to the next generation” Dan offers three real-life examples of the intergenerational transfer of unique properties; the first highlights some of the perils of common ownership, and the other two explore how the use of a corporate entity – in this case the limited liability company – can help avoid those difficulties. This information will prove helpful in the difficult task of passing on special family properties in a way that limits the inevitable family conflict.

During this global pandemic one major concern has been the stress on families and family offices. To help with this we have a valuable and thoughtful submission by David Werdiger (Australia), “Stress tests – building resilience in the face of a crisis”. His article, using case studies, explores how family systems have reacted – for better or worse – to the Covid-19 health risk and how their ability to respond has been reflected in their foundations of good governance and shared values.

The first case study he uses is an example of the “weight of expectation”. He refers to the boxer Mike

Tyson who said, “Everybody has a plan until they get punched in the mouth”. David describes a number of families and their varying abilities to “get back up” after being knocked down. He shows the value of good governance and how it leads to resilience in the family and the family office. He also makes the case for keeping governance on the front burner, not the back burner – it needs to be there when it is needed, as in the present time.

We invited James (Jay) Hughes (United States) to submit an updated unpublished reflection on the importance of ritual in families. It seems reassuring during this pandemic to refer to traditions and rituals in families. In his piece, entitled “A reflection on the art and practice of ritual within a family governance system”, Jay reminds us that every family has rituals, and asks: “What are some of the important life stages of individual family members and of the family as a whole that rituals within families might be created to honour?” His answer, with examples from families, include the traditional events such as coming of age, becoming an elder, a new member by birth, a marriage, a death. He muses that there could be new kinds of rituals when there is a time to celebrate after the pandemic, “We can, however, look forward to them and the sunny days of our lives they will represent”. He closes with some optimism:

I can imagine that these celebrations will be of unusual size and importance as we and our families acknowledge that we survived, that we learned all we could sitting on the banks of our rivers for our shared futures, and with confidence, courage and creativity we embrace our new rivers and the possibilities they auger.

Back to the pandemic environment – Pete Shanley (Australia) and Eric Powell (United States) demonstrate from their strong backgrounds in the family office security arena how important it is to have up-to-date security strategies. Their article, “Covid-19 impact on family office risk management strategies” highlights the need for solid security strategies. They warn:

Without exception, the most talked about subject within the family office risk management community today is the Covid-19 pandemic, its triggering of an economic crisis and threats to law and order, and how best to manage all of these events. We are faced with a threat to our family offices from multiple vectors simultaneously.

They review in detail 11 areas of concern in risk management. In addition, they stress how important it is to share information in the family office network. Building resilience for the unknown will not be easy, but they close with advice for the future:

The crises faced by the next generation may not be as forgiving, so all that can be done to build out long-term resilience and pave the path for future generations should be done. Never waste a good crisis.

With or without a pandemic, data protection has

become ever-more regulated, affecting family offices and family trusts, as explained by Emma Haley (United Kingdom):

We live in an increasingly regulated world and data protection is an area of more extensive compliance since the introduction of the EU's General Data Protection Regulation (GDPR) in May 2018. Family offices across Europe will therefore be familiar with the GDPR as part of their compliance and administration responsibilities, both in running the family office itself and looking after a family's entities and affairs.

Emma examines recent guidance and gives a recap of the basic requirements of GDPR in the context of non-charitable English law trusts and estates. The article lists a number of action items that trustees and executors might consider, including: conducting an audit of what data is held and why; who it is shared with; how long it will be kept; arrangements for keeping it secure and up to date; procedures to identify and report breaches as well as complying with subject access requests; reviewing contracts with others to whom the information is disclosed to ensure they too are GDPR compliant; taking care when sending information to a third party and implementing further checks and safeguards when sending to those outside the EEA; registering with the ICO; developing a policy and complying with the record-keeping requirements of their processing activities, where required; and issuing privacy notices to relevant beneficiaries and other data subjects. She closes with the warning that failure to comply can result in criminal penalties.

Another article on the impact of Covid-19 comes from Spain. This is of particular interest to the many individuals who are spending more time, because of the pandemic, at their holiday homes in Spain as there can be serious tax consequences. As Patricia García Mediero (Spain) explains:

Given the large number of foreign individuals with second homes in Spain and a stable presence in this country, tax residence is one of the main target areas of the Spanish tax inspection. Inspection practices and resources have been materially enhanced following the recent creation of the Central Unit for Private Wealth, now fully operational. These investigations often result in large tax assessment and lengthy court cases – sometimes under tax fraud charges – and are based on an increasingly aggressive interpretation of the Spanish and Treaty provisions regarding an individual's tax residence situation.

She advises that individuals examine their tax residence status in order to determine their potential exposure on a potential Spanish tax audit:

This is especially important for individuals who are not declaring themselves as tax resident anywhere, or claim to be tax resident in a low tax jurisdiction, or in a jurisdiction with special tax regimes (eg, Portugal, Italy,

United Kingdom), all while having a stable presence in Spain or retaining economic or other ties to this country.

The tax rates are high – the current general marginal income tax rate for regular and investment income for Spanish tax resident individuals is set at 45% and 23% respectively – post-Covid, this may go up to around 50% and 27%. There is also an annual wealth tax.

She closes with a plea to family offices:

We encourage family offices to start a dialogue with principals with a view to maximising the use of current highly advantageous tax regimes in Spain to transfer wealth to the next generation in a structured, tailored and tax beneficial manner, considering not only the Spanish tax implications but the overall effect in all jurisdictions concerned.

The next author, Melissa Cowley Wolf (United States), has been working with younger philanthropists and shares some fascinating trends she has been observing in her article, “The next generation of strategic cultural philanthropy”. She explains that funding of the arts has been undergoing a profound shift, as several intersecting trends and events are changing both the landscape of philanthropy and wealth management. She has been concerned to see a reduction in traditional giving to the arts, reporting that of the many conversations she is part of, “these conversations share the one particular and vital item: they all become conversations about relevance, and why the rising generations of high-net-worth individuals are not invested in the arts”.

The author uses the findings of a number of studies to show that the motives of the younger philanthropists are different – they want to make a difference. This means there may be a change in the type of giving, but Melissa points them to new forms of giving, in line with their interests:

The next gen has been telling us how they want to give, and the global events of 2020 can help accelerate the process of remaking the model. By partnering with the arts sector, the rising gen can lead conversations about how the arts can drive social justice to mitigate our biggest global problems, the very problems that this generation is dedicated to solving. They can be at the forefront of redefining arts funding for a new century.

Speaking of the arts we have another delightful piece by Ronald Varney (United States), “The phantom of Sutton Place: collectors visible and invisible”. No pandemic stresses in this article.

Ron begins with a critical view of the flashy excesses of the contemporary art market, which have been ‘on pause’ during the pandemic but which he assures us will be springing right back. During this pause he uses the quiet time to dig up the hidden stories of several noteworthy collectors in the past. Drawing on his experience at Sotheby’s, Ron puts together several intriguing back stories of collectors who worked at being invisible, unlike collectors today. Ron’s article has no tax or regulatory concerns, just some fun stories that collectors large and small will enjoy.

In our Luxury Corner for this issue it is a pleasure to include a piece by Laurie Wickwire (United Kingdom), a certified diamond grader, on all you ever wondered about on the topic of diamonds from Namibia! Where did they come from? How did they get there? What is their future?

For our column On Wealth we are pleased to include for our first time the well-known family wealth expert Lee Hausner (United States). Lee explains why it is so important to develop competencies in children and gives great examples on how to do just that.

Our Media Review comes from Eugene Lipitz (United States), a member of our editorial board. Eugene discusses works on the pre-civil war United States, comparing that era to now and to a large family system, with this concluding sobering thought:

Will we face it as the best of that former generation would have had us do it: with malice toward none and in the spirit of family seeking renewal? Will we do any better than they did in following this advice? Signs are not good in the United States, as old hatreds are inflamed on left and right and the nation’s wounds, notwithstanding the toll paid in blood, still refuse to heal. The Antebellum United States sacrificed an entire generation of young people who were not there to remake their country. We have no such deficit today. Will our young people be a brave first generation, or, thinking themselves rebels, make no genuine break with the past and sink into the unforgiving spirit of their forbearers?

Lastly, we continue to express our gratitude to STEP for their list of news alerts.

We thank all the wonderful contributors and hope that our readers find value, comfort and inspiration during these unusual times!

Barbara Hauser

International private wealth clients in Spain – a quick post-Covid outlook

Patricia García Mediero

To a material extent, the impact of the Covid-19 crisis in Spain will be determined by the success of the economic policy actions already put in place and those expected to be put in place throughout 2020 and 2021. This fiscal response, resulting in unprecedented injections of both domestic and EU public funds into the Spanish economy, will also likely have substantial implications in terms of tax policies. Taxes, including personal taxes, are likely to increase substantially in the short to medium term.

An individual's exposure to Spanish personal taxes depends on their tax residence status, as determined by the Spanish domestic law and the provisions of any relevant Double Tax Treaty. Tax residence tests under Spanish law consider: presence in Spain; economic ties to Spain; and/or close family ties to Spain. Tie break tests under Double Tax Treaties largely adopt the OECD model.

Individuals who are tax resident in Spain in any given calendar year will generally be taxed on a worldwide basis for income, wealth and inheritance, and gift tax purposes. They will also be under an obligation to file Foreign Asset Information Returns (Form 720, largely considered the Spanish version of the US FBARs). Individuals who are non-tax resident in Spain in any given calendar year will only be taxable on a Spanish situs/source basis and will have no Form 720 obligations.

Given the large number of foreign individuals with second homes in Spain and a stable presence in this country, tax residence is one of the main target areas of the Spanish tax inspection. Inspection practices and resources have been materially enhanced following the recent creation of the Central Unit for Private Wealth, now fully operational. These investigations often result in large tax assessment and lengthy court cases – sometimes under tax fraud charges – and are based on an increasingly aggressive interpretation of the Spanish and Treaty provisions regarding an individual's tax residence situation.

Consequently, individuals, including settlors, grantors and/or beneficiaries of trusts and/or foundations, who declare themselves as non-tax resident in Spain but are spending a stable amount of time in this country, or have a substantial Spanish asset base or activities, or have been reported as tax resident under CRS, FATCA or any other Information Exchange mechanism, are strongly recommended to examine their tax residence status in order to

determine their potential exposure on a potential Spanish tax audit.

This is especially important for individuals who are not declaring themselves as tax resident anywhere, or claim to be tax resident in a low tax jurisdiction, or in a jurisdiction with special tax regimes (eg, Portugal, Italy, United Kingdom), all while having a stable presence in Spain or retaining economic or other ties to this country.

The current general marginal income tax rate for regular and investment income for Spanish tax resident individuals is set at 45% and 23% respectively – post-Covid, this may go up to around 50% and 27%.

Spanish tax resident individuals with passive investments abroad may fall under the punitive Spanish CFC provisions for income tax purposes. This may have a special impact on individuals with US, Canadian, Dutch, Luxembourg or other similar holding structures. Spain also has exit tax provisions in the form of a taxable gain deemed arising on 31 December of the last year of Spanish tax residence. This may, however, be postponed in a number of situations and there are special provisions for transfers of tax residence within the European Union.

In addition to income tax, Spain also levies wealth tax on an annual basis. For Spanish tax resident individuals, this generally applies to an individual's net worth over €700,000, with a marginal rate of 2.5% for a net asset base over €10.7 million. This is a tax devolved to the regions, so situations change significantly on a regional basis – Madrid enjoys a full exemption from the tax.

Substantial amendments to wealth tax are widely expected in the short to medium term, possibly before mid-2021, and this may result in anything from a completely new tax on wealth (arguably less likely), to a full reintroduction of the tax in Madrid, as well as a change in asset valuation rules, away from the traditional acquisition cost rules and into a mark-to-market basis, and the inclusion of investments currently outside the scope of the tax, including certain foreign unit-link insurance wrappers.

Spanish tax resident individuals holding interests in non-Spanish assets are generally under an obligation to file Foreign Asset Information returns (Form 720). The European Commission has, however, taken recent action against Spain before the European Court of Justice (Case 2019/C432/35) regarding potential discriminatory elements in the law, which

A popular option among individuals considering impatriating to Spain is the application of the Special Impatriation regime for Spanish personal tax purposes.

would eradicate the most punitive elements of the legislation regulating the Form. However, no court resolution is expected before year-end 2021.

As for Spanish inheritance and gift tax, this is levied on heirs and donees, who are taxed on a worldwide basis if they are tax resident in Spain. Non-Spanish tax resident heirs and donees are taxed on free acquisitions of Spanish situs assets. The protection granted to cross-border estates is very limited – Spain only provides limited certain unilateral tax credit relief and only has Double Tax Treaties covering this tax with France, Sweden and Greece.

At present, International Private Wealth clients and cross-border estates may apply regional benefits on close family free transfers, albeit by application of complex provisions, which may bring Spanish inheritance and gift tax charges down to almost nil.

However, it is likely that these tax reductions will be materially reduced, possibly during the first semester of 2021, which would result in a full reintroduction of the tax with rates which could potentially range around 28% to 32%.

Therefore, individuals who are either tax resident or non-tax resident in Spain should address their exposure to Spanish inheritance and gift tax with a view to maximising the tax planning opportunities provided by the current tax benefits, before their likely abolishment or curtailment during 2021. This would include the possibility of making gifts of legal title over properties, shares or other assets to the next generation while retaining beneficial ownership (a legal right of use).

A popular option among individuals considering impatriating to Spain is the application of the Special Impatriation regime for Spanish personal tax purposes. This is a six-year regime available to employees, directors or members of the board of a Spanish company in which the individual ultimately holds less than 25% of its shares. Under this regime, the individual is only subject to Spanish income tax on Spanish source income and gains, as well as employment income worldwide. Spanish wealth tax

is limited to net Spanish situs assets. There are no Form 720 reporting obligations. However, there is no protection granted to the spouse and children or against Spanish inheritance and gift tax.

Individuals applying this regime have become the focus of Spanish tax audits, with increasingly stringent interpretations of the law resulting in large tax assessments and in some cases court action under tax fraud charges. Therefore, individuals who have applied this regime at any time during the past five years are strongly encouraged to review their specific basis of application of this regime.

Taxpayers who remain uncompliant or have applied untenable technical positions in their Spanish tax returns (this is typically the case of vested beneficiaries of trusts who fail to disclose their interests for Spanish personal tax purposes) are strongly advised to consider entering into a voluntary disclosure procedure in order to avoid potential Spanish tax fraud charges and hefty penalties.

Family offices, whether single or multi-family offices, play a pivotal role in assisting clients in addressing, planning, executing and coordinating their global personal tax strategies. Personal risks associated with uncompliant situations, many times out of sheer lack of awareness of local tax rules, is a growing area of concern among principals, who may in the worst case scenario end up being subject to criminal proceedings or with tax assessments in the millions.

Family offices are in a unique position to assist clients, including international families, in reviewing their Spanish overall personal tax situation and assessing the impact of the likely future tax increases.

We encourage family offices to start a dialogue with principals with a view to maximising the use of current highly advantageous tax regimes in Spain to transfer wealth to the next generation in a structured, tailored and tax-beneficial manner, considering not only the Spanish tax implications but the overall effect in all jurisdictions concerned.

Patricia García Mediero is Head of the International Private Wealth practice of Avantia Asesoramiento Fiscal y Legal, a firm solely focused on Private Wealth. Her practice has gained significant industry recognition – among others, she is ranked among the top 200 global practitioners by AML's Private Client Global Elite.