Baker McKenzie.

Commentary

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Estate planning for political headwinds in Asia - a Taiwanese perspective

In brief

One of the main challenges facing the US and its western allies is forging a common front with China without it spilling over into direct confrontation. "Unlike the war in Ukraine, which must eventually reach some kind of messy conclusion, the rivalry between the US and China is a project without an end," stated a recent Financial Times article. This assumes in large part that the situation in Taiwan remains unchanged. For people in Taiwan, this perilous fate lies entirely in the hands of others, the US and China most prominently.

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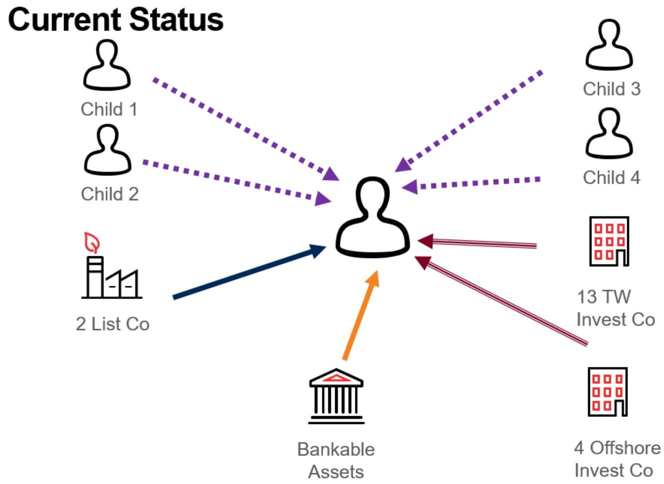
In more detail

What then can wealth owners in Taiwan do affirmatively in a situation like this? Particularly when succession planning is already on the table. What additional factors should be reviewed in a timely fashion? Note that political instability is not unique to Taiwan. Even in Asia, there are potential flashpoints in many other locations.

To preserve client confidentiality, we draw from a number of actual client cases and set out the following hypothetical to illustrate the diversity of issues and planning that must be considered in today's environment:

Mr. Chen, a sprightly man in his early 80s, built a sizable fortune in the past 40 years. The core of the family wealth was in pharmaceuticals, with about a dozen companies in Taiwan and China selling medicine, medical supplies and equipment originating from leading US and European producers. The ownership structure of these companies was complex. Many were controlled by investment companies and nominee individuals (who were current or past business associates and employees of Mr. Chen). Over the years, Mr. Chen also amassed an impressive suite of real estate and shares in private and public companies. The real estate was all in Taiwan, ranging from properties used by the pharmaceutical business (such as offices and warehouses) to other commercial and residential properties that produced sizable income. The shares in which he invested were mostly held through investment companies (with the nominee structures like that of the business) and some in the individual names of Mr. Chen and his family members. They included companies listed in Taiwan and the US and a number of start-ups that were moving to initial public offering in the next three to five years.

Mr. Chen was married with four grown children, each of them with their own families. Mr. Chen was a Taiwanese national and resident and lived in Taiwan for most of his adult life. His children were all educated in the West, some in the US and some in Canada. Many of the children were now living in the US and Canada and were not involved in the family business.



After an initial consultation with Mr. Chen to ascertain his overall objectives, we suggested that the family/Mr. Chen consider prioritizing the following five goals/workstreams:

Workstream 1 - Business restructuring
Workstream 2 - Assets diversification
Workstream 3 - Family migration
Workstream 4 - Overall succession considerations
Workstream 5 - Considerations in the event of political instability

Workstream 1 - Business restructuring

We explained to Mr. Chen the apparent legal and practical risks associated with his current holding structure, which relied heavily on the use of personal nominees and special purpose vehicles (SPVs). In practice, these structures are often vulnerable to litigation risks, tax challenges, creditors' claims and, more recently, regulatory scrutiny arising from KYC/AML requirements and other concerns. In our meetings with Mr. Chen and company executives, we also learned that this holding structure was cumbersome to maintain as it required significant internal accounting adjustments to move revenues and expenses around SPVs. We proposed to the client that we should take the following steps to restructure the business:

- **Rethink how the businesses can be run more efficiently.** This required a deeper dive with the business executives now running the operating companies to understand the overall businesses, their current operations and future prospects, plus an understanding of how they were managed and the interplay between them now and in the future. The goal was then to come up with a pro forma business structure that makes commercial sense.

- Once the operating structures were mapped out, we needed to think through **how they should be owned and, ultimately, where the family control would come into play**. We explained to Mr. Chen and the family that to "unwind" the current nominee arrangements, these shares would need to be restructured. In the Taiwanese legal context, this would be accomplished either as a sale or a gift, each with different cash flow and tax implications. Through several meetings with the family's treasury and finance personnel, we determined the applicable fiscal and tax implications and proposed a number of alternatives for the family to consider.

- Ultimately, we needed to decide **how the shareholding of the various SPVs (given the final restructured organizational chart) should be held**. This was the most sensitive and private discussion we had with Mr. Chen and required us to understand his overall wishes in relation to family succession. This led naturally to Workstream 4 (overall succession considerations).

Workstream 2 - Assets diversification

In addition to the operating companies, Mr. Chen and his family had significant personal assets both in Taiwan and offshore. As a complement to Mr. Chen's overall succession considerations, we shared with him our experience working with other Taiwanese families who diversified their assets in the recent past to maximize long-term returns and minimize security risks. As part of that exercise, Mr. Chen could consider liquidating some of the assets (such as real estate) and diversify them across asset classes and jurisdictions. Informed by our experience working with families dealing with the recent Russian sanctions, we also discussed the importance of having multiple banking relationships in multiple jurisdictions.

Depending on where these assets were and the current ownership, there might well be foreign exchange regulations, personal tax implications and cash flow issues that needed to be considered. With the insight we have gained working with other families (and corporations), we were able to construct an overall action plan listing detailed steps to strike and balance between these myriads of considerations.

Workstream 3 - Family migration

Mr. Chen, though only a Taiwanese citizen and resident, had an international family. This was quite common with similar Taiwanese clients with whom we work. The objective of this workstream was to work through the "people" aspect of the family tree, understanding the family members' current locations and where they envision themselves to be in the short-, medium- and long-term future. Integral to the inquiry is to document the key family members' legal identifications, passports and permanent residencies. In the various discussions, we also gained an understanding of the key family members' current and future marital statuses to anticipate issues that may arise in connection with these "life events." We reminded Mr. Chen that there is no "right" or "wrong" answer to many of the choices that the family would make, including where the future generations will want to live and work, from which country or countries (if any) additional passports may be obtained, whether to use private contracts such as prenuptial agreement, etc.

In our discussion with Mr. Chen and the family members, personal safety was frequently raised as an issue. Often, we see this combined with the establishment of a family office or an (offshore) philanthropy vehicle.

Workstream 4 - Overall succession considerations

This workstream lay at the core of his family planning. Like many of his contemporaries, Mr. Chen had not made a will and it was culturally difficult to discuss this subject openly within the family. Our strategy was to look at what was already there — here we see that, with respect to the holding companies in the various investments, Mr. Chen had over the years transferred partial ownership to the second generation by way of gift (with the requisite gift tax paid). Our strategy in moving the discussion forward was to understand the following:

- Did Mr. Chen have a different expectation in mind with respect to passive/investment assets and operating businesses? If Mr. Chen would be like many other clients with whom we have worked, he would likely want to have stronger "control" (that extends beyond his death) with respect to his operating companies but be more relaxed with respect to the passive investment assets.

- If our assumption above was generally correct, we would propose more long-term solutions for Mr. Chen in relation to his operating business. The tools that could be considered included trusts, charitable foundations, holding companies and insurance policies. For listed companies, we might use a combination of onshore and offshore planning techniques to mitigate risk under Taiwanese securities law and included both Taiwan trusts and offshore trusts. With respect to charitable foundations, we explored with him whether family members already had charities that they support, private charitable foundations that they had set up and run, and what other alternatives they might be open to. Here we will work with Mr. Chen by showing him how some of the well-known Taiwanese families had used Taiwanese charitable foundations as the cornerstone of their overall estate plan, and by showing the benefits and risks of these structures. We reminded Mr. Chen that, given recent changes in law, charitable foundations could be less suitable as a family-holding vehicle.

- Regarding the more passive investments, one of the possibilities we explored with Mr. Chen was the use of a "family office" to centralize decision-making and ownership. We showed him examples of some family offices in Singapore, which had become popular with many Taiwanese and Chinese high-net-worth families in the past few years.

- Central to all these discussions was an understanding of what Mr. Chen believed his legacy would be. We tried to have an open and far-ranging discussion with him on the role of wealth, the definition of "family," the expectation he had of his heirs and other more intangible topics. As such discussions could be long and evolving, with the implementation of his objectives to be accomplished in stages, we suggested that we would create more concise documents in the meantime to memorialize such discussions. As has been tested with other client families, our objective here was to develop a set of structures, activities and statements that help sustain the identity, direction and discipline of the Chen family and family businesses with the ultimate goal of their long-term success.

Workstream 5 - Considerations in the event of political instability

Given the potentially fraught geopolitical environment surrounding Taiwan, we discussed with Mr. Chen and the family that additional planning should be considered. Although not an exact parallel, the lessons learned from the Russian invasion of Ukraine serve as a starting point. The issues to consider with the family were as follows:

- The possibility of sanctions on the Chinese economy and Chinese companies. As part of the family's business was in China and there were assets/income streams that were related to China, future sanctions could result in restrictions on trading, financial services and capital conversion. The family should consider the impact on its businesses if some of its financial accounts are temporarily frozen or blocked. Also relevant is the planning required when banks are sanctioned and the importance of "deposit rule" and where cash is kept.

- We reminded Mr. Chen that in the event of sanctions, the jurisdiction of the trust (as used in the family's overall planning in Workstream 4) would be critically important. As we have seen in the recent experience, there are only some offshore jurisdictions (where a trust is typically based) that did not apply sanctions.

- A review of the travel documents for Mr. Chen and the key family members, and an investigation of the possibility of obtaining additional passports and places of residency. While this is always an important consideration for long-term mobility planning, one lesson we have learned from the Ukraine example is that it was mandatory to have a residency in the US or Europe to avoid sanctions. We also discussed the potential issues when the concept of "in-scope Russians" may apply to "in-scope Chinese."

The above hypothetical case illustrates the challenge of estate planning in an age of uncertain political environment. We remember in the last century, when Hong Kong was reverting back to China, many estate planners at that time were devising structures with additional safeguards (such as an automatic redomiciliary provision in a trust that may be triggered by a force majeure event). However, since that time, this part of Asia has witnessed a few decades of relative peace and prosperity, and with it the creation of additional wealth and complacency. Today, instability is not limited to Europe and there are potential flashpoints in North Asia and Southeast Asia. Is now the time to be more vigilant than before?

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