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International Wealth Planning for Political Risk

International Wealth Planners
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Overview

- Bilateral Investment Protection Agreements
- tax consideration
- trusts

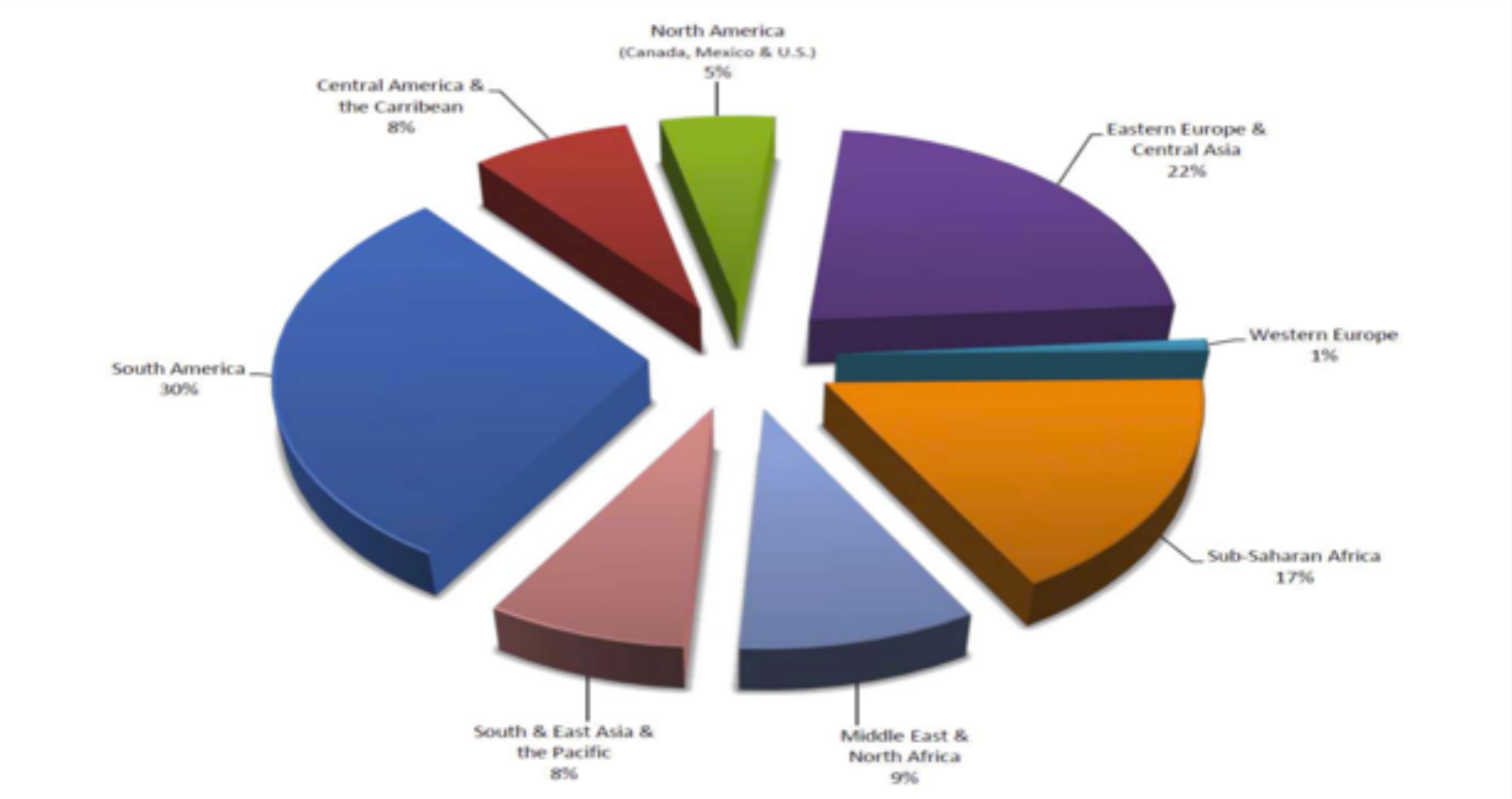
What is Political Risk?

- a country has complete control over persons and property within jurisdictional reach
- “rogue” governments can prejudice foreign investors
- foreign exchange controls
- expropriation / compulsory purchase below market value
- arbitrary cancellation of government licenses or concessions

Examples

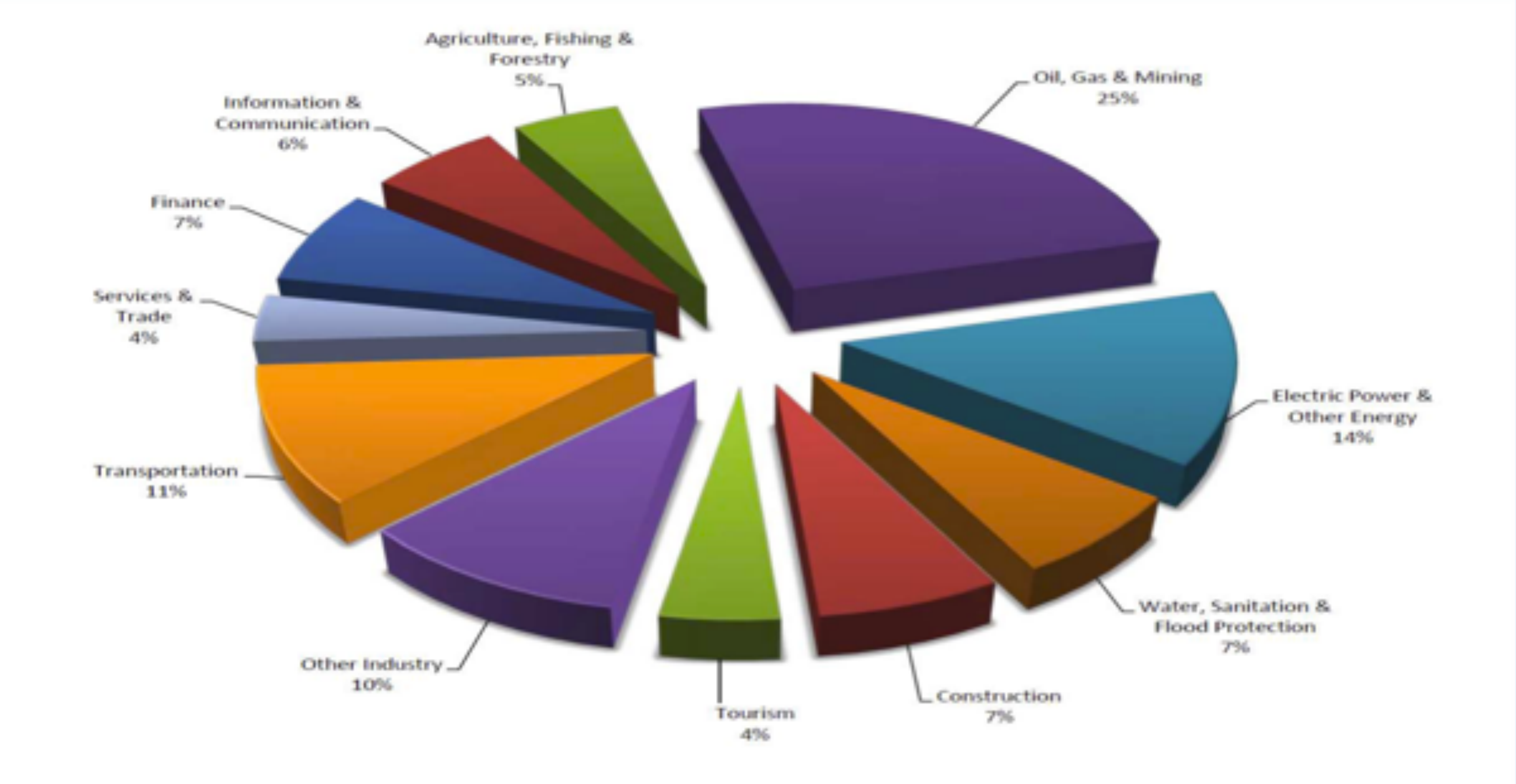
- Argentina – YPF (Repsol)
- Bolivia – Red Electrica
- Venezuela – Exxon

Geographic Distribution of ICSID Cases



Source: The ICSID Caseload - Statistics (2010)

ICSID Cases by Economic Sector



Source: The ICSID Caseload – Statistics (2010)

Overview of Planning Strategies

- shift risk
  - insurance
  - replace equity with bank financing
  - take investment public spreading risk
- reduce risk
  - investment protection treaties

Investment Protection Treaties

- bilateral sovereign to sovereign agreements (2500 treaties)
- mechanically similar to tax treaties
- private sector parties are given rights against host governments
- typically available to individuals, companies, partnerships, trusts
- apply to nationals, tax residence is not required
- EU moving into the area
- free trade agreements may provide similar protections

Treaty Protections

- fair and equitable treatment
- full protection and security
- national treatment
- unrestricted transfer of investments and returns
- compensation for:
  - expropriation (including compulsory purchase at undervalue)
  - arbitrary licence termination
  - changes to government concessions
- umbrella clauses
- injunctive relief / specific performance seldom available

What to Look for in a Treaty

- “most favoured nation” protection
- inclusion of indirect investments
- requirement to register investments
- enforcement through ICSID
- excluded industries

Planning Considerations

- timing for making the investment
- host country investors
- different levels of government
- tax and regulatory issues with foreign ownership

Enforcement Process

- arbitration by independent international tribunal established under auspices of UN or World Bank
- venue outside the host jurisdiction
- enforcement rights against (non-diplomatic) assets of defaulting host sovereign in 165 countries
- no requirement at any stage to resort to courts in host jurisdiction

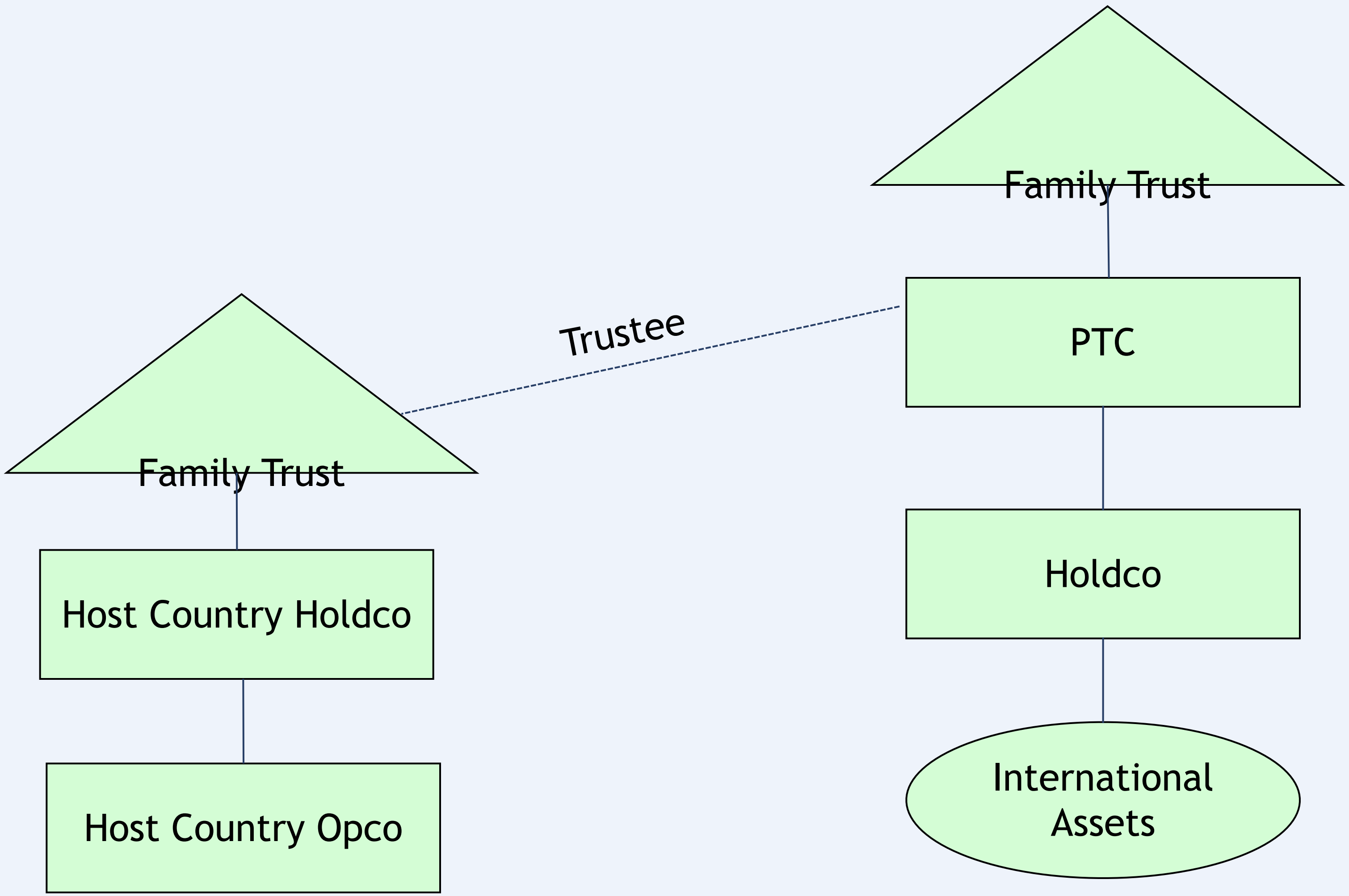
Limitations/Disadvantages

- expensive and lengthy arbitration
- treaties can be terminated
- however, rights preserved on treaty cancellation
- government reprisals

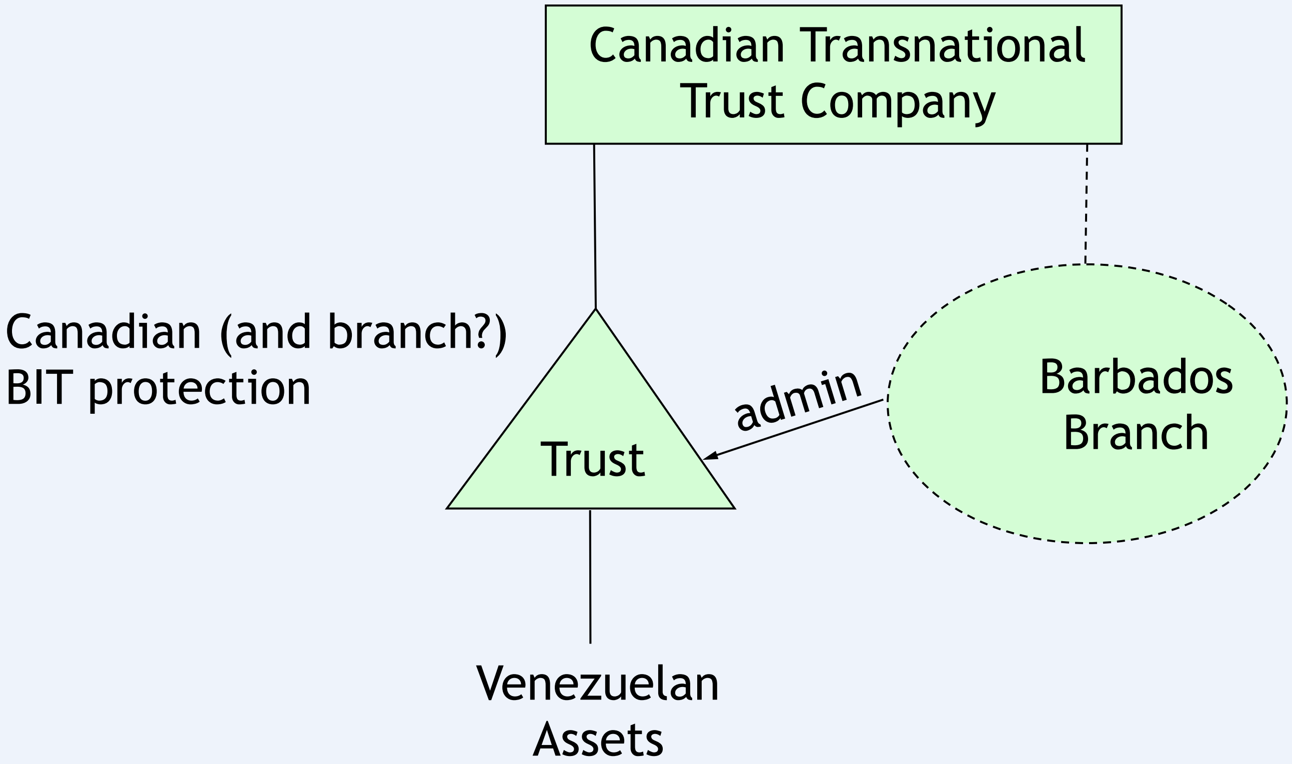
Commercial Uses

- corporate investors in emerging market natural resources, infrastructure, realty
- international funds (e.g. private equity, sovereign wealth)
- pension and other institutional investors
- management exposures for not protecting corporate assets?
- Public-Private Partnerships

Political Risk Planning For Local Assets



Canadian Transnational Trust Company



Tax Considerations

- client's home country
- host country
- tax treaties
- EU Parent-Subsidiary / Interest and Royalties Directives
- participation exemption regimes

Tax Treaties

- reduction of tax barriers
- reduced non-resident withholding tax for dividends, interest and royalties
- allocation of taxing rights (e.g. capital gains)
- elimination of double taxation
- prevention of tax evasion

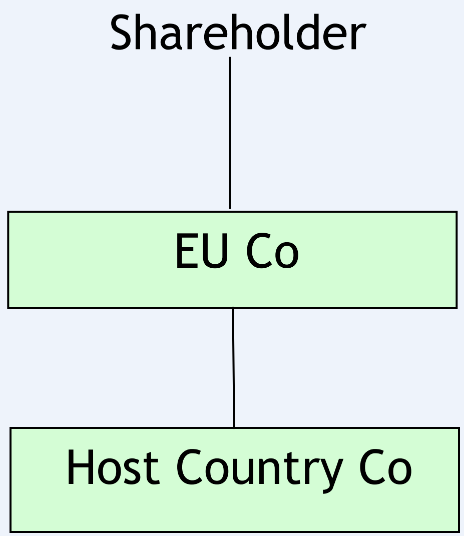
EU Directives (Dividends, Interest and Royalty)

- payments between EU qualifying entities
- no withholding tax on dividends, interest and royalties
- elimination of double taxation of dividends at parent level (exemption or tax credit)
- minimum holding:
  - 10% (dividends)
  - 25% (interest and royalty), proposed reduction to 10%

Participation Exemption Regimes

- mainly in the EU
- eliminate (or reduce) tax on dividends and capital gains (not interest)
- minimum holding requirements (percentage (or cost), and period of time)
- usually foreign subsidiary must:
  - conduct an active business; and
  - be subject to comparable foreign tax

BIT and Tax Structure



- EU Co provides BIT protection

EU Co:

- reduce or eliminate NRWHT in EU
- participation exemption on dividends and capital gains
- tax treaty protection on capital gains in host country

Host Country Co:

- reduced treaty NRWHT rate

Trusts

- remove settlor powers if duress
  - who exercises settlor powers?
  - reversion to the settlor
- change beneficiaries if political risk event occurs

Conclusions

- political risk exposures are significant in emerging markets, and increasing elsewhere
- investment protection treaties suspend the usual sovereign defences against investor claims
- negotiation leverage in a dispute
- compensation for government interference where treaty protection avails
- integrate tax and investment protection planning

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