COLLAS CRILL

FATCA , CDOT, CRS: Nowhere to hide

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With the globalisation of the financial sector, it is now much easier for individuals and corporate entities to hold assets outside their jurisdiction of tax residence. The automatic exchange of financial account information is geared towards improving transparency in the offshore jurisdictions in order to tackle cross border tax evasion.

The Common Reporting Standard ("**CRS**") widens, and in some instances replaces, the existing regimes for Automatic Exchange of Information. The enactment of FATCA, in 2010, by the United States of America, had as its aim, the reduction of tax evasion by US citizens and entities. As is now well established, FATCA requires financial institutions outside the US to pass information about their US customers to the Internal Revenue Service.

FATCA was followed by CDOT (The Crown Dependencies and Overseas Territories Agreements). CDOT established a reciprocal agreement with, among others, the three Crown Dependencies and Gibraltar and the UK, to identify, maintain and report information on financial accounts held by individuals and entities resident for tax purposes in those territories. The good news for the compliance teams of Guernsey based financial institutions (query whether anyone will be able to feel upbeat!) is that reporting under CDOT is likely to be short lived, as it will be incorporated by reporting under CRS.

CRS is the brainchild of the Organisation for Economic Co-operation and Development, whose initiative has been to move towards a coordinated approach to disclosing the income of individuals and entities. The initiative was driven by the G20 countries, to maximise efficiency and reduce costs, for financial institutions ("**FIs**") by implementing the approach taken by FATCA.

Of the 96 jurisdictions that have committed to information exchange, the early adopters (Guernsey being one) have a deadline of September 2017 in respect of 2016 transactions, and the remainder have until 2018, to supply information on the FIs that will be shared with the relevant participating jurisdictions. This number is not fixed, so there is an expectation that over time, Guernsey will need to adapt and expand its exchange agreements with participating jurisdictions.

CRS, like FATCA, requires the interests of those with ultimate effective control over a structure to be reported. In the trust context, this will include settlors, protectors and beneficiaries (whether fixed or discretionary). Any distributions made to discretionary beneficiaries during the course of 2015, will be reportable in 2017 for the early adopter jurisdictions.

Every legal entity resident in a participating jurisdiction must be classified as either an FI or a non-financial entity ("**NFE**"). NFEs are further sub-classified into Active or Passive NFEs. The categorisation of Active NFEs is

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such that most private client trusts with a trustee who is not a professional trustee, will be treated as Passive NFEs. A Passive NFE includes any 'Investment Entity' that has a situs in a jurisdiction that has not signed up to the CRS. The burden of compiling the relevant information and reporting it to the relevant tax office will fall on compliance departments, and those involved in handling the structure. Whilst the responsibility of liaising with individuals or entities who are affected by CRS will lie with members of the organisation who interact with the end client. This means that the already necessary process of collating and storing AML and CDD information will be even more important. Information will be passed automatically each year to the relevant tax office where an individual or entity is resident.

Many purely administered entities, including trusts and their underlying companies, will be classified as FIs. Where the trust is a Passive NFE it will have an obligation to disclose information to an FI, such as a bank, where the reportable account is maintained. The FI will be required to identify the 'Controlling Persons' (the settlor, trustees, protector and beneficiaries) of that Passive NFE. 'Entity' under the CRS, includes trusts, partnerships and foundations. For Fiduciaries, it will be necessary to establish whether a trust is resident in a particular participating jurisdiction. The CRS rules say a trust is resident in the participating jurisdiction where one or more of its trustees are resident.

Importantly, tax residency, and not citizenship in a participating jurisdiction, is the determining factor for CRS.

Participating jurisdiction's relevant tax offices worldwide, have been investing heavily in resources to process, and cope, with the deluge of additional data and information that will flow through their doors over the coming years. Guernsey's 'Information Gateway Online Reporting System,' is the portal through which Guernsey's FIs will file their reports. There is as yet no global template on which the participating jurisdictions can rely. This may change as the process of reporting develops.

The CRS information that is required to be exchanged will include much the same as for FATCA: the identity and residence of financial account holders, account details, reporting entity, account value and income.

The expectation is that previously undisclosed information will be passed amongst relevant tax offices. This information overload is likely to provoke those relevant tax offices to make further enquiries of the FIs, leading to a significant increase in Tax Investigation Exchange Agreements.

Those FIs who, last year, filed with their relevant tax office their first reports for FATCA, will be best placed to overcome the hurdles presented by CRS.

Confidentiality will be a key consideration. The information exchanged under CRS, on an annual basis, amongst relevant tax offices worldwide, will be sensitive, and in the context of trusts, will disclose the identities of personnel who, previously, benefitted from a degree of anonymity. Taxpayers may legitimately have concerns about information being automatically exchanged with jurisdictions that have less technological advances in data security, or political instability.

The changes that CRS are introducing present challenges as well as opportunities. Those involved with entities or structures or who have interests in a reportable entity, need to be aware of the implications of CRS. The

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future, particularly for trust structures, is likely to see an overall simplification in how assets are set up or, for existing structures, how they are held going forwards.

Particular considerations for clients may include, narrowing the beneficial class, or stripping out protector provisions altogether, in order to reduce unnecessary reporting obligations for those classed as exercising ultimate effective control. Similarly, if a beneficiary or protector is resident in participating jurisdictions where there are data security concerns, then consideration should be given to excluding or changing those individuals. Finally, a debt owed by a trust, which is a FI, may constitute a reportable account. Some thought should be given to the appropriateness of maintaining such loans where the reporting obligations will be overly burdensome or time consuming.

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COLLAS CRILL

For more information please contact:



Angela Calnan

Partner (Advocate) | Guernsey

t: +44 (0) 1481 734233 | **e:** angela.calnan@collascrill.com

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