The OECD common reporting standard (CRS): FATCA is going global

The CRS poses new compliance challenges for financial institutions

By Dr. Hans Martin Schmid and Dr. Eike W. Grunert

The OECD Common Reporting Standards will facilitate worldwide enforcement of money laundering and tax evasion crimes.

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Recently, financial institutions in Germany and throughout the world have had to comply with ever-increasing regulatory requirements and enforcement activity. Many of those requirements were imposed in the wake of the 2008 financial crisis, aimed at making the global financial system less vulnerable to incidents such as the subprime mortgage crisis. Additionally, a great number of requirements were—and still are—based on increasing efforts to fight money laundering, terrorist financing and tax evasion. Indeed, states have expanded their focus beyond offenders and are now also targeting financial institutions, not only as potential co-perpetrators of these crimes but also as involuntary (but powerful) assistants to the authorities in collecting necessary facts and evidence.

The U.S.: alone at the vanguard for a long time

When it comes to fighting tax evasion through offshore accounts, until very recently, the United States was somewhat alone at the vanguard. Most notably, –>

over the past years the U.S. succeeded in rolling out the worldwide implementation of the U.S. Foreign Account Tax Compliance Act (FATCA) that provides for, among other things, the automatic exchange of information between the U.S. and states and financial institutions that commit to FATCA reporting, requiring the automatic disclosure of information relating to U.S. account holders who have preexisting accounts or who open new accounts with financial institutions in FATCA-participating countries.

Yet fighting tax evasion is a common interest and challenge for jurisdictions all over the world. Cooperation across national boundaries and the automatic exchange of financial account information between tax authorities are considered essential in this fight. These goals led to the development of the CRS, a regime similar to FATCA but creating reciprocity among dozens of states. Financial institutions will be facing the impending implementation of this global compliance burden, increasing the risks and costs of servicing those customers who hold and manage investments through financial institutions outside of their country of tax residence.

The imminent CRS has a relatively short history. On February 13, 2014, the Organization for Economic Cooperation and Development (OECD), following initiatives by finance ministers and central banks of the G20 member states, released a global "Standard for Automatic Exchange of Financial Account Information". The new standard uses the international FATCA regime as a blueprint. If implemented as widely as scheduled, it will lead to what perhaps can best be described as "Global FATCA", comprising the automatic exchange of financial account information between all states that commit to participate. The standard consists of a model bilateral agreement between the participating CRS reporting states, covering data protection issues and procedures for collaborating on compliance and enforcement between national governmental agencies. The CRS, an annex to the standard, describes due diligence requirements for financial institutions, including the specific types of accounts that they must identify and the scope of data that needs to be reported on those accounts.

Next step: early adopter states and others are on track

By October 2014, around 60 so-called "early adopter states", including Germany, had committed to swiftly implement CRS in domestic laws and to exchange financial account data starting as early as September 2017. Another 40 states have agreed to start data exchange in 2018, and additional states may follow.

>> **Financial accounts to be reported under CRS include depository and custodial accounts as well as equity or debt interest in the financial institution itself** <<

Financial institutions that have already implemented processes and systems for FATCA aim to leverage those processes for CRS. The main differences between CRS and FATCA are driven by the multilateral nature of CRS, and by FATCA criteria that are specific to the U.S., including the U.S. concept of taxation on the basis of citizenship, and the presence of a significant and comprehensive FATCA withholding tax. Notably, the FATCA regime is limited to reporting on financial data of U.S. account holders only, and thus the volume of data required to be collected and reported under CRS will be tremendously higher, covering data on all financial accounts whose direct or indirect holders are tax residents in any of more than 100 participating states. Further, as states commit to participation over time, reporting under CRS will be implemented incrementally, requiring financial institutions to observe multiple deviating deadlines as new CRS reporting states join, and further adding to the complexity of implementation.

CRS reporting will be mandatory for a range of financial institutions including custodial institutions, depositary institutions, investment entities or specified insurance companies. Branches of foreign financial institutions that are located in any of the CRS reporting states will also be subject to CRS. Financial accounts to be reported under CRS include depository and custodial accounts as well as equity or debt interest in the financial institution itself.

CRS rules distinguish between individual/entity accounts and preexisting/new accounts, and include requirements to look through passive entities to report on the controlling persons. With regard to preexisting accounts, financial institutions will be obligated to perform comprehensive due diligence throughout their customer data to assess the tax residence of all account holders and controlling persons. Mandatory due diligence requirements include electronic searches for indicia of tax residency in another CRS reporting state such as current mailing or residency address, telephone numbers, outbound standing instructions, powers of attorney or signature →

authorities granted to persons resident abroad, and hold-mail instructions or an "in-care-of" address in another CRS reporting state, if that in-care-of address is the sole address on file for the account holder or controlling person.

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For accounts exceeding $1 million in value, due diligence requirements further include manual searches through certain paper records unless a financial institution's electronically searchable data includes fields for, and reliably captures, all of the information to be searched, as well as inquiries to relationship managers regarding their actual knowledge about the account holder's tax residency.

For new customers, financial institutions will have to collect self-certifications regarding tax residency. For preexisting individual accounts, financial institutions will be obliged to review accounts without application of any de minimis threshold. Preexisting entity accounts below $250,000 in value, however, will not need to be reviewed under CRS by the financial institutions.

Financial information to be reported under CRS includes the name, address, tax identification number (TIN), date and place of birth of each account holder and controlling person (or any such relevant information for legal entities) with tax residency in one or more other CRS reporting state(s). Moreover, account number, account balance or value and total gross amounts of interest, dividends, income from certain insurance products, sales proceeds from financial assets and other income generated with respect to assets held in the account, or payments made from the account have to be reported. Financial institutions are required to report this information to their national tax authority or other competent authority. In Germany, this will be the Federal Central Tax Office (Bundeszentralamt für Steuern). These authorities will, in turn, provide the information to the competent authorities in all other CRS reporting states. →

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For the early adopter states, including Germany, the expected timeline for reviewing, identifying and reporting on the existence of reportable accounts is the end of December 2016 for accounts with a value above $1 million, and the end of December 2017 for accounts of lower value. Reporting of the actual detailed account information as described above to the other CRS reporting states is due by the end of September of the following year.

Outlook: further challenges ahead?

Will the impacts of CRS be limited to the costly compliance burden for financial institutions, or can further challenges be expected? Inevitably, the automatic exchange of detailed account information through CRS will significantly increase the opportunities for further investigations through the taxation authorities in all CRS reporting states, including quick and cost-effective technology-based reviews. Thus, the new transparency on a global basis may lead to enhanced enforcement actions, directed not only against tax evaders, but also against financial institutions. Ultimately, and probably in exceptional cases only, this may include allegations of banks collaborating in money laundering, terrorist financing or tax evasion. Examples might include (a) actively supporting customers

in hiding undeclared assets by disguising account holder identities through nominees or sham legal entities (b) making incorrect statements about beneficial owners in certifications that are relevant for taxation or (c) target-oriented recruiting of foreign investors using strict local banking secrecy laws as a shield against disclosure. Financial institutions should be aware of this risk, and, when preparing to implement the new CRS standards, take measures to secure and compile information that may become relevant to address such types of allegations where appropriate. Notably, financial institutions should consider internal investigations or other remediating measures to assess and mitigate potential risks in this regard. Irrespective of implementation costs and other challenges triggered, CRS will undoubtedly become an important tool for the global fight against tax evasion through offshore accounts. <-

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