MOORE STEPHENS

An analysis of the Common Reporting Standard

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Family offices

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Contents

1. Introduction

The OECD published the Common Reporting Standard (CRS) for the Automatic Exchange of Financial Account Information on 13 February 2014. Financial institutions resident in CRS countries will report account holder information to their local tax authorities who will then exchange information with countries where account holders are tax residents.

The Common Reporting Standard is a game-changer in the global fight against tax evasion. More than 90 jurisdictions have already committed to adopting CRS and there are more than fifty early adopters, with the first automatic information exchanges to happen in 2017.

CRS will work in a similar way to the United States FATCA regulations, although it does not itself impose withholding taxes for non-compliance.

In the European Union, CRS will be implemented through the Directive on Administrative Co-operation. Whilst the United States has no immediate plans to adopt CRS, it is already receiving financial account information through the FATCA regulations. There are very few hold-outs who have not yet agreed to adopt the CRS – Bahrain, the Cook Islands, Nauru, Panama and Vanuatu.

2. General reporting requirements

Reporting financial institutions have an obligation to review their financial accounts to identify reportable accounts by applying due diligence rules, and then report relevant information to their local tax authority:

Reporting financial institutions must report the following information on each reportable account:

- name, address, jurisdiction of residence, Taxpayer Identification Number (TIN) and date of birth of each reportable person, and, in the case of an entity, each controlling person who is a reportable person;
- account balance or value as at the end of the relevant year (or on date of closure of the account);
- for custodial accounts, interest, dividends, other income, gross proceeds from sale or redemption paid or credited during the year;
- for depository accounts, gross interest paid or credited in the year;
- for other accounts, the gross amount paid or credited during the year.

There are exceptions, for example where a TIN is not issued by the relevant jurisdiction, or where financial institutions are not required to obtain dates of birth under domestic law.

3. Reporting financial institutions

The first step is to determine the CRS status of an entity such as a corporation, partnership, trust or foundation:

Financial institution (FI)	Banks, custodians, investment entities, or specified insurance companies
Non-financial entity (NFE)	An entity that is not an FI

Those entities classified as reporting financial institutions will be required to comply with the reporting requirements set out above. The category includes investment entities.

Investment entities

Under CRS, investment entities comprise:

- **funds, investment managers and fund administrators** who primarily conduct as a business investing, administering or managing funds, for and on behalf of a customer (the activities test); or
- **managed investment entities** where gross income is primarily attributable to investing, reinvesting or trading financial assets, and the entity is itself managed by an FI (the managed investor test).

'Primarily' in this context means that gross income attributable to the relevant activities exceeds 50 per cent of gross income during the shorter of:

- the preceding three calendar years; or
- the period since inception.

The practical application of the managed investment entity category requires further consideration. An entity will be an investment entity if it is investing on its own account, is managed by a financial institution and it meets the financial assets test described below.

The precise definition of 'managed by' will vary from jurisdiction to jurisdiction, but it will for example include those cases where an FI acts as discretionary investment manager or corporate trustee. Where an entity is managed by a mix of institutions and individuals, it will meet the definition if one of the institutions is an FI.

The financial assets test

An entity meets the financial assets test if its gross income is primarily attributable to investing, reinvesting or trading in financial assets.

This means that gross income attributable to investing exceeds 50 per cent of gross income during the shorter of:

- the preceding three calendar years; or
- the period since inception.

Financial assets include:

- securities;
- partnership interests;
- commodities;
- derivatives.

Under the CRS, financial assets specifically exclude direct interests in real property. Hence a company whose sole asset is an investment property will not be an investment entity, nor will a real estate investment fund.

An entity would generally be considered to fall within one of the categories of investment entity if it functions or holds itself out as a collective investment vehicle, mutual fund, exchange traded fund, private equity fund, hedge fund, leveraged buy-out fund or similar investment vehicle.

Some useful illustrative examples are provided by HM Revenue and Customs based on the United Kingdom regulations:

Investment advisor
Advice Limited provides advice on and discretionary management of securities held by a number of clients. The securities meet the definition for being 'financial assets'. Almost 80% of the gross income of Advice Limited for the last three years has come from providing such services. Advice Limited primarily conducts a business of managing financial assets on behalf of clients and is therefore an investment entity.

Investment fund
Investment fund X primarily invests in equities on behalf of customers. Fund X is managed by Invest Co Limited, a financial institution. Fund X was formed two years ago since when it has earned 90% of its income from these activities. Fund X is an investment entity because it primarily conducts as a business one or more of the relevant activities for or on behalf of a customer. It is not relevant that it is managed by a financial institution as it is an investment entity by virtue of its business activities.

Family trust with a corporate trustee
The ABC family trust's gross income is primarily attributable to investing, reinvesting or trading in financial assets. The trust was set up on the advice of a law firm and that firm's own corporate trustee is the trustee of the trust. The corporate trustee acts for the law firm's clients without itself charging any fees to the clients. Even though the corporate trustee does not charge, it is a financial institution as its related entity (the law firm) is charging the clients for these services, it primarily conducts as a business for or on behalf of a customer the prescribed activities. This in turn means that the ABC family trust is an investment entity.

Specified insurance companies

Specified insurance companies are those that deal with investment products such as cash value insurance contracts and annuities.

The term 'cash value' means the greater of:
- the amount the policyholder is entitled to receive upon surrender or termination of the contract; and
- the amount the policyholder can borrow against the contract.

It excludes death benefits, personal injury or sickness benefits and refunds of premium paid.

4. Non-reporting financial institution

Non-reporting financial institutions include:
- government entities, international organisations or central banks;
- most government or employer pension funds;
- most credit card issuers;
- exempt collective investment vehicles where the investors are themselves non-reporting; and
- trusts, where the trustee is itself a reporting FI and reports on the trust.

5. Non-financial entities

An NFE is any entity that is not a financial institution.

An active NFE means any NFE that meets any of the following criteria:

- less than 50 per cent of gross income in the preceding calendar year or other appropriate reporting period is passive income and less than 50 per cent of the assets held by the NFE during the period are passive income-generating assets;
- the stock of the NFE (or an entity which controls the NFE or is controlled by it or is under common control) is regularly traded on an established securities market;
- the NFE is a government entity, an international organisation, a central bank or an entity wholly owned by one of the foregoing;
- substantially all of the activities of the NFE consist of holding the stock of (or providing financing and services to) one or more subsidiaries that are themselves NFEs. (Investment funds, private equity funds, venture capital funds and similar investment vehicles do not qualify for this status);
- the NFE is less than two years old, not yet operating a business but is investing capital into assets with the intent to operate a business other than that of an FI;
- the NFE was not an FI within the past five years, and is in the process of liquidation or re-organisation with the intent of commencing/re-commencing in a business other than that of an FI;
- the NFE primarily engages in financing and hedging transactions with, or for, related entities (an entity which controls the NFE or is controlled by it or is under common control) which are not FIs, and does not provide financing or hedging services to unrelated entities, provided the group is primarily engaged in a business other than that of an FI; or
- most not-for profit organisations, such as religious bodies, charities, scientific, cultural, athletic or educational organisations, professional organisations, business leagues, chambers of commerce, labour organisations, agricultural or horticultural organisations, civic leagues or social welfare organisations, provided that such organisations cannot make distributions to non-charities.

A passive NFE means an NFE that is not an active NFE, or an investment entity that is not a participating jurisdiction FI where gross income is primarily attributable to investing, reinvesting or trading financial assets, and the entity is itself managed by an FI.

The distinction between active and passive NFEs is important because financial institutions such as banks will collect data from their account holders and will report controlling persons of passive NFEs if they are resident in a CRS jurisdiction.

6. Financial accounts

Financial accounts refer to accounts maintained by an FI, such as bank accounts, custody accounts, cash value insurance contracts and annuity contracts, and equity interests in a partnership or a trust.

Under CRS, an equity interest in a trust is considered to be held by any person treated as a settlor or beneficiary, or any other person (such as a protector) exercising ultimate effective control over the trust. A reportable person is considered to be a beneficiary of a trust if they have the right to receive directly or indirectly (for example, through a nominee) a mandatory distribution or may receive, directly or indirectly, a discretionary distribution from the trust.

7. The treatment of trusts

Trusts as financial institutions

The most likely scenario in which a trust will be a financial institution is if it falls within the definition of an investment entity. This is the case when a trust has gross income primarily attributable to investing, reinvesting or trading financial assets and is managed by a financial institution. In this case, the financial accounts are most likely to comprise the equity interests in the trust. The holders of the equity interests will be treated as account holders for reporting purposes.

The equity interests are held by a trustee, settlor or beneficiary or any other person (such as a protector) exercising ultimate effective control over the trust. A discretionary beneficiary will only be treated as an account holder in the years in which it receives a distribution from the trust, and the trustees will report the value of distributions made to reportable persons. A settlor or mandatory beneficiary will always be an account holder, and the trustee reports their account balance, as well as gross payments paid or credited during the year. Unless otherwise defined (for example where a beneficiary has a defined equity interest), their account value will be the total value of all trust property.

Account holder	Account balance or value	Gross payments
Settlor	Total value of all trust property	Value of payments made to the settlor in the reporting period
Mandatory beneficiary	Total value of all trust property	Value of distributions made to the beneficiary in the reporting period
Discretionary beneficiary	Nil	Value of distributions made to the beneficiary in the reporting period
Trustee and protector	Total value of all trust property	Value of distributions made to such person in the reporting period

Where an account is closed during the year, for example where a beneficiary is removed, the fact of closure is reported.

The trust will apply the due diligence rules in the CRS in order to identify the residence of its account holders. If any of the account holders are themselves entities, that entity must be looked through, and the ultimate natural controlling persons behind the entity must be treated as the equity interest holder.

Trusts as non-financial institutions

If a trust is not an FI, it will be a non-financial entity (NFE). Some trusts such as registered charities and trading trusts will be classified as active NFEs. Otherwise it will be a passive NFE. In addition, if a trust is holding a financial account with a reporting financial institution, the FI must treat the trust as a passive NFE if its gross income is primarily attributable to investing, reinvesting or trading financial, it is managed by an FI but is not resident or located in a participating jurisdiction.

If an NFE holds an account with a reporting financial institution, the FI may be required to report the trust for CRS purposes. An account held by a passive NFE is a reportable account if the trust has one or more controlling persons that are reportable persons. The concept of controlling person used in the CRS is drawn from the 2012 FATF Recommendations on Beneficial Ownership. As such, the controlling persons of a trust are the settlors, trustees, beneficiaries, protectors and any other natural person exercising ultimate effective control over the trust. Where the beneficiaries are not individually named but are identified as a class, the CRS does not require that all possible members of the class be treated as reportable persons. Rather, when a member of a class of beneficiaries receives a distribution from the trust or intends to exercise vested interests in trust property, this will be a change of circumstances, prompting additional due diligence and reporting as necessary.

A settlor is reported regardless of whether it is a revocable or irrevocable trust. Likewise, both mandatory and discretionary beneficiaries are included in the definition of controlling persons. Unlike the case of an equity interest in a trust that is a reporting financial institution, discretionary beneficiaries of passive NFEs are reported regardless of whether a distribution is received in a reporting period. However, when implementing the CRS, an individual jurisdiction may opt to allow reporting financial institutions to align the scope of beneficiaries reported as controlling persons with the scope of those reported as Reportable Persons. In such case the reporting financial institution would only need to report discretionary beneficiaries in the year they receive distributions from the trust.

In summary, a reporting financial institution will report the following information with respect to reportable controlling persons of a passive NFE trust account holder:

Account holder	Account balance or value	Gross payments
Settlor	Total value of all trust property	Value of payments made to the settlor in the reporting period
Mandatory beneficiary	Total value of all trust property	Value of distributions made to the beneficiary in the reporting period
Discretionary beneficiary (assuming the above option applies)	Nil	Value of distributions made to the beneficiary in the reporting period
Trustee and protector	Total value of all trust property	Value of distributions made to such person in the reporting period

Where an account is closed during the year, the fact of closure is reported.

Trust residence

A trust will be considered to be resident where the trustee is resident. If there is more than one trustee, the trust will be a reporting financial institution in all participating jurisdictions in which a trustee is resident, and each would separately report in respect of their reportable accounts. However, if the trust is considered to be resident for tax purposes in a particular participating jurisdiction, and the trust reports the required information, that will relieve the trust from reporting in the jurisdictions of residence of the co-trustees. In order to obtain such relief, each trustee should be able to demonstrate that all necessary reporting by the trust is actually taking place.

8. Excluded accounts

The following accounts are excluded:

- most retirement or pension accounts;
- most other tax-favoured accounts, where annual contributions are limited to $50,000 or less;
- most life insurance contracts without termination benefits;
- accounts held by an estate where the will or death certificate are held;
- accounts established under a court order and most conveyancing accounts.

9. Due diligence requirements

An account is treated as a reportable account beginning as of the date it is identified as such by due diligence, and will be reported annually in the calendar year following the year to which the information relates.

The balance or value of an account is determined on the last day of the calendar year.

Pre-existing individual accounts

The following procedures apply for the purpose of identifying reportable accounts:

Lower value accounts < $1 million

- If the reporting FI has a current residential address for the account holder, based on documentary evidence, the account holder may be treated as being resident for tax purposes in the jurisdiction of the address.
- If the reporting FI does not rely on the current residential address, it will review electronically searchable data for the following indicia of residence:
  - current mailing or residence address;
  - telephone number;
  - standing instructions to transfer funds;
  - power of attorney; and
  - 'hold mail' instruction or 'care of' address (in which case a paper search applies).

- If any of the indicia are identified, the reporting FI will treat the account holder as a resident for tax purposes of the reportable jurisdiction for which an indicium is identified.
- Any of the indicia may be rebutted by a self-certification from the account holder or documentary evidence establishing the account holder's non-reportable status.

Higher value accounts > $1 million

Additionally the FI will make inquiries with the relationship manager and review:

- account opening instructions;
- AML/KYC documentation;
- powers of attorney;
- standing instructions to transfer funds.

New individual accounts

The reporting FI will obtain a self-certification from the account holder and confirm the reasonableness based on its normal AML/KYC documentation and procedures.

Pre-existing entity accounts

Unless the reporting FI elects otherwise, a pre-existing entity account with a value less than $250,000 is not required to be reviewed. For higher value accounts, the reporting FI will review the following documentation to identify whether the account is held by a reportable person or by a passive NFE with one or more controlling persons who are reportable persons:

- AML/KYC documentation;
- self-certification (if the documentation indicates that the account holder is resident in a reportable jurisdiction).

New entity accounts

The reporting FI will obtain a self-certification from the account holder and confirm the reasonableness based on its normal AML/KYC documentation and procedures.

10. Timetable

Each jurisdiction will set its own timetable, for example United Kingdom:

Pre-existing financial accounts to be subjected to due diligence procedures are those in existence as at	31 December 2015
New financial accounts requiring self-certification by the customer are those opened on or after	1 January 2016
First reporting period ends on	31 December 2016
Information to be reported by	31 May 2017
Information to be exchanged with partner jurisdictions	30 September 2017

11. Definition of terms

Term	Definition
Account holder	The person listed or identified as the holder of a financial account.
Controlling persons	The natural persons who exercise control over an entity. In the case of a trust, such term means the settlor, the trustees, the protector (if any), the beneficiaries or class of beneficiaries, and any other natural person exercising ultimate effective control over the trust. The term 'controlling persons' is interpreted in a manner consistent with the Financial Action Task Force Recommendations.
Documentary evidence	Documentary evidence includes: • certificate of residence issued by a government body; • for an individual, ID issued by a government body that is typically used for ID purposes; • for an entity, official documentation issued by a government body; • audited financial statements, credit report, bankruptcy filing, securities regulator report.
Excluded account	The following accounts are excluded: • most retirement or pension accounts; • most other tax-favoured accounts, where annual contributions are limited to $50,000 or less; • most life insurance contracts without termination benefits; • accounts held by an estate where the will or death certificate are held; • accounts established under a court order and most conveyancing accounts.
Financial account	Accounts maintained by an FI, such as bank accounts, custody accounts, cash value insurance contracts and annuity contracts, and equity interests in a partnership or a trust. Excluded accounts are not included.
Financial asset	Financial assets include: • securities; • partnership interests; • commodities; • derivatives. Under the CRS, financial assets specifically exclude direct interests in real property.
Financial institution (FI)	Custodial institution, depository institution, investment entity or specified insurance company.
Investment entity	Under CRS, investment entities are: • entities which primarily conduct as a business investing, administering or managing funds, for and on behalf of a customer; or • entities where gross income is primarily attributable to investing, reinvesting or trading financial assets, and the entity is itself managed by an FI. 'Primarily' in this context means that gross income attributable to the relevant activities equals or exceeds 50 per cent of gross income during the shorter of: • the preceding three calendar years; or • the period since inception.

Non-financial entity (NFE)	An entity that is not a financial institution. An active NFE means any NFE that meets any of the following criteria: • less than 50 per cent of gross income in the preceding calendar year or other appropriate reporting period is passive income and less than 50 per cent of the assets held by the NFE during the period are passive income-generating assets; • the stock of the NFE (or an entity which controls the NFE or is controlled by it or is under common control) is regularly traded on an established securities market; • the NFE is a government entity, an international organisation, a central bank or an entity wholly owned by one of the foregoing; • substantially all of the activities of the NFE consist of holding the stock of (or providing financing and services to) one or more subsidiaries that are themselves NFEs. (Investment funds, private equity funds, venture capital funds and similar investment vehicles do not qualify for this status); • the NFE is less than two years old, not yet operating a business but is investing capital into assets with the intent to operate a business other than that of an FI; • the NFE was not an FI within the past five years, and is in the process of liquidation or re-organisation with the intent of commencing/re-commencing in a business other than that of an FI; • the NFE primarily engages in financing and hedging transactions with, or for, related entities (an entity which controls the NFE or is controlled by it or is under common control) which are not FIs, and does not provide financing or hedging services to unrelated entities, provided the group is primarily engaged in a business other than that of an FI; or • most not-for profit organisations, such as religious bodies, charities, scientific, cultural, athletic or educational organisations, professional organisations, business leagues, chambers of commerce, labour organisations, agricultural or horticultural organisations, civic leagues or social welfare organisations, provided that such organisations cannot make distributions to non-charities. A passive NFE means an NFE that is not an active NFE, or an investment entity that is not a participating jurisdiction FI where gross income is primarily attributable to investing, reinvesting or trading financial assets, and the entity is itself managed by an FI.
Non-reporting financial institutions	Non-reporting financial institutions include: • government entities, international organisations or central banks; • most government or employer pension funds; • most credit card issuers; • exempt collective investment vehicles where the investors are themselves non-reporting; • trusts, where the trustee is itself a reporting FI and reports on the trust.
Related entity	An entity is a related entity of another entity if either entity controls the other, or the two entities are under common control. For this purpose control includes direct or indirect ownership of more than 50 per cent of the vote and value in an entity.
Reportable account	An account held by one or more reportable persons or by a passive NFE with one or more controlling persons that is a reportable person.
Reportable person	An individual or entity that is resident in a reportable jurisdiction, other than: • a corporation whose stock is regularly traded on an established securities market; • a related entity of the above; • a government entity, international organisation or central bank; • a financial institution.
Reportable jurisdiction	CRS jurisdiction
Specified insurance company	Specified insurance companies are those that deal with investment products such as cash value insurance contracts and annuities. The term 'cash value' means the greater of: • the amount the policyholder is entitled to receive upon surrender or termination of the contract; • the amount the policyholder can borrow against the contract It excludes death benefits, personal injury or sickness benefits and refunds of premium paid.

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