# *OECD publishes long anticipated Commentary on Common Reporting Standard*

*July 28, 2014*

## *In brief*

The Organisation of Economic Cooperation and Development (OECD) on July 21, 2014 released the *Standard for Automatic Exchange of Financial Account Information in Tax Matters*, including the Commentary on the Common Reporting Standard (CRS). CRS seeks to establish the automatic exchange of tax information as the new global standard. The automatic exchange of information involves the systematic and periodic transmission of 'bulk' taxpayer information from the country which is the source of the payment to the taxpayer's country of residence. The published Commentary is the OECD's interpretative guidance on the CRS model.

Similar to the provisions of the Foreign Account Tax Compliance Act (FATCA) and the various intergovernmental agreements (IGAs) between the Internal Revenue Service (IRS) and partner governments around the world, CRS imposes obligations on financial institutions (FIs) across the financial services market to review and collect information in an effort to identify an account holder's country of residence and then in turn, to provide certain specified account information to the home country's tax administration. It is expected that FIs, such as banks, insurance companies and investment funds, in countries adopting CRS will be required to undertake the necessary due diligence obligations beginning in 2016 with reporting starting in 2017.

An early adopter group of over 40 jurisdictions announced publicly on May 6, 2014 their commitment to conclude a Competent Authority Agreement (CAA) with an effective date of January 1, 2016. Since May, an additional 25 adopters have joined and it is expected that there will be over 100 adopters in the near future.

The adoption of the CRS for the automatic exchange of information was completed in a relatively short time frame. The OECD managed to produce the Model Competent Authority Agreement (Model CAA), the CRS model and the Commentary in little more than a year. There is also an agreement on the Common Technical Solutions which is closely aligned to the FATCA reporting schema and technological infrastructure.

An OECD Global Forum meeting is scheduled to take place in Berlin at the end of October. It is expected that many of the 120 Global Forum member countries, particularly the early adopter countries, will participate in a signing ceremony for CRS and agree individual CAAs.

Given that the Italian presidency of the European Union (EU) has prioritized the adoption of information exchange as a goal for its six month term, which began July 1, 2014, it appears that the proposed timetable for implementation may not change. Within the EU, CRS is expected to come into effect through a multilateral EU Directive due to the fact that the list of countries intending to join CRS includes most EU member countries.

It remains to be seen if alignment within the EU is possible between CRS and other initiatives relating to information exchange that are evolving simultaneously, such as the existing Directive on Administrative Cooperation (DAC) and/or the EU Savings Directive (EUSD). The EU accepted a revision to the EUSD in March 2014, which would need to be implemented in local EU Member State laws by January 1, 2016, taking effect on January 1, 2017. However, the EU council intends to harmonise the requirements under these reporting regimes.

## In detail

### *Summary of the CRS*

CRS provides reporting and due diligence standards to support the automatic exchange of financial account information. Participating jurisdictions are expected to have rules in place that require financial institutions to follow due diligence procedures and report information consistent with the standards established by CRS.

The types of financial institutions covered by CRS include custodial institutions, depository institutions, investment entities and specified insurance companies, with some institutions being eligible to be excluded due to presenting a low risk of being used for tax evasion.

Similar to FATCA the due diligence procedures distinguish between individual accounts and entity accounts as well as provide for a distinction between preexisting and new accounts.

- *Preexisting individual accounts* - financial institutions are required to review accounts regardless of the account balance; however, there is a distinction between requirements for Higher and Lower Value Accounts. For Lower Value Accounts a permanent residence address test based on documentary evidence or residence determination based on an indicia search is required. Conflicting indicia would need to be resolved with a self-certification (and/or documentary evidence). Without this, reporting would need to be performed for all reportable jurisdictions for which indicia have been found. Enhanced due diligence procedures will apply to Higher Value Accounts, including a paper record search and an actual knowledge test of the relationship manager for the account.
- *New individual accounts* - a self-certification and subsequent confirmation of its reasonableness is required. There is no de minimis threshold available.
- *Preexisting entity accounts* - financial institutions are required to determine whether the entity itself is a Reportable Person. Furthermore, FIs are required to determine whether the entity is a passive non-financial entity (NFE) and if so, to determine the residency of the Controlling Persons. This can generally be accomplished on the basis of available information such as that collected from anti-money laundering (AML)/know your customer (KYC) procedures. However, in cases where this information is not sufficient, a self-certification would be required to establish whether the entity is a Reportable Person. Individual jurisdictions may opt to allow financial institutions to apply a threshold to make preexisting entity accounts below USD 250,000 (or local currency equivalent) not subject to review.
- *New entity accounts* – these accounts are subject to the same type of evaluation as preexisting accounts. However, the option for the USD 250,000 (or local currency equivalent) threshold does not apply as it is less complicated to obtain self-certifications for new accounts.

Reportable accounts include accounts held by individuals and entities including trusts and foundations. There is also a requirement to look through passive entities to be able to report on the relevant controlling persons.

Information to be reported includes interest, dividends, account balance / value, 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 with respect to the account.

Additionally, a description of the rules and administrative procedures expected to be established by an implementing jurisdiction to ensure effective implementation of CRS and compliance with its provisions, is included.

***Recap of the Model CAA***

The Model CAA is arranged in seven sections.

*Section 1* includes definitions, and it should be noted that these are less comprehensive than Article 1 of the Model 1 IGA as some of the definitions have been moved to form part of the CRS Commentary.

*Section 2* covers the types of information to be exchanged and follows the Model 1 IGA, with the additional provision that tax residencies of the account holder are also required.

*Section 3* addresses the time and manner of the exchange of information. Competent authorities are required to exchange information by the end of September of the year following the year to which the information relates. This is the same requirement as under the FATCA Model 1 IGA.

*Section 4* requires the competent authority jurisdictions to notify each other in the event of incorrect or incomplete reporting or non-compliance by an FI. Each jurisdiction is expcted to achieve compliance and address non-compliance through their domestic laws.

*Section 5* contains the confidentiality and data safeguards required of the competent authorities. As noted in the overview to the documents, a jurisdiction must have the administrative capacity and processes to ensure confidentiality of data received before entering into an agreement.

*Sections 6 and 7* allow for consultations between the competent authorities, amendments to the agreement and the terms of the agreement, including suspension in the event of significant non-compliance and the termination of an agreement with 12 months notice.

In addition to the Model CAA providing the framework for automatic exchange of tax data, the CRS includes more detailed reporting and due diligence requirements as well as defined terms. The Commentary, in turn, provides further guidance on how to interpret the individual requirements set by the Model CAA as well as the CRS.

***Observation:*** *Section 5 of the Model CAA and corresponding confidentiality and data safeguard provisions may prevent certain jurisdictions from entering into a CRS agreement until they have addressed local data protection and data security issues.*

***Other highlights of the CRS commentary***

While the Commentary consists of over 300 pages, we have listed 16 relevant highlights that will impact financial institutions around the world:

*Implementation*

**1. The wider approach**

As it is anticipated that the number of countries eventually joining CRS will be consistent with the countries that committed to IGAs with the US Treasury, the Commentary provides for the concept of a 'wider approach'. This so-called wider approach aims to enable FIs to obtain and store all the tax residencies of account holders and to rely on previously obtained self-certifications, which can then be used to report on the necessary accounts as new countries join CRS. However, in many countries existing data protection rules may prevent FIs from requesting such data without legal accommodations and thus such information may only be collected from account holders on a voluntary basis.

***Observation:*** *Governments should aim to adopt the wider approach as it would minimise the need for FIs to repeatedly ask account holders about their status as the number of agreements in effect increases over time. Moreover, it would prevent FIs from needing to build complex information technology solutions to keep track of the account holder status under different CAAs.*

*Identification*

**2. Residence address test**

Government issued documents that do not contain a specific address can still be used as documentary evidence if the residence address on file is in the same jurisdiction as the government that issued the document.

***Observation:*** *For example, the account holder's passport can be relied upon to determine the tax residency of the account holder under the resident address test for preexisting individual accounts.*

**3. Records**

It has been made clear that the 'records' of the FI include both electronically searchable information as well as the customer master file.

**4. Preexisting accounts also include the new accounts of a preexisting customer**

The Commentary allows a new account of a preexisting customer to be treated as a preexisting account, provided the following conditions are met:

- the account holder holds a preexisting account with the reporting FI (or with a related entity in the same jurisdiction of the reporting FI),
- the FI treats both accounts as one single account for applying the standards of knowledge and account aggregation,
- existing AML/KYC procedures allow the FI to satisfy the

requirements by relying upon the AML/KYC procedures performed for the preexisting accounts, and

- the opening of the new account does not require the provision of new, additional or amended customer information by the account holders for purposes other than CRS.

***Observation:*** *The extension of the preexisting account definition is expected to be welcome relief for many FIs, particularly those already sharing documentation between accounts. Otherwise, it would have been disruptive for such businesses to* have *to execute the full new account due diligence procedures for every new account of a preexisting customer.*

**5. Guidance on controlling persons**
The guidance on the definition of controlling persons was revised to further clarify its meaning under relevant Financial Action Task Force recommendations and the interaction with applicable AML/KYC rules.

**6. The use of publicly available information**
The Commentary makes it possible for FIs to rely on publicly available information or other information in the possession of the FI to classify account holders who are FIs and active NFEs.

***Observation:*** *This is a concession to the industry appeals as FIs are able to single out a reliable public source of information such as Standardized Industry Classification-codes or the IRS foreign financial institution (FFI) list. This would mean that many account holders could be classified without needing to be approached for a self-certification.*

**7. Reasonableness test**
The Commentary clarifies that the 'reasonableness' test applied by an FI needs with respect to the self-certification of an account holder is limited to establishing that the FI does not have any contradictory information in its records.

**8. Guidance on unclassified entities**
Entity account holders for which the FI cannot establish the CRS classification should be assumed to be passive NFEs and the controlling person information should be reviewed for CRS indicia.

***Observation:*** *This is an area that shows governments have learned from the IGA implementation under FATCA. Clear guidance has been given to FIs with respect to classifying entities and the controlling persons thereof when no self–certification is obtained. This will lead to greater transparency through the reporting of unclassified entities and their controlling persons.*

*For example, an Irish entity that has a bank account at a UK bank refuses to provide a self-certification; the UK bank must then classify the account as an Irish reportable account provided that these countries have signed an agreement with each other. Furthermore, it will review the controlling person information of the Irish entity for indicia. Should the controlling persons have, for example, indicia of German status, then the account also becomes a German reportable account based on the status of the controlling persons.*

**9. Changes of circumstances – 90 day period**
In case of a change in circumstances that leads to the CRS status of the account holder no longer being valid, the FI may rely on the previous CRS status for a period of 90 days.

***Observation:*** *The 90 day period provides a workable solution for FIs that have to process a change in circumstances for an account holder, especially around the year-end period. Monitoring for changes in circumstances will likely be based on the FATCA process FIs have implemented, although the indicia under CRS differ from FATCA, which means that the process will need to be enhanced.*

*Reporting*

**10. Year-end status determines account status**
The Commentary clarifies that the determination of whether an account is a reportable account is based on the status of the account as per year end.

**11. Reasonable efforts**
In many cases, the FI will not have the tax identification number (TIN) and date of birth of account holders. In such cases, it must make 'reasonable efforts' to obtain these from the account holder. Reasonable effort means that at least once a year, during the period between the identification of the preexisting account as a reportable account and the end of the second calendar year following the year of that identification, an effort is made to acquire this data from the account holder, either by contacting the account holder or by reviewing electronically searchable information maintained by the FI or a related entity of the FI. There is no requirement to limit the use of the account by the account holder during an attempt to obtain the TIN and date of birth.

**12. Reporting of account balances on closed accounts**
Originally both FATCA and CRS required that in the case of accounts that are closed during the year, the account balance prior to closure should be reported. The Commentary has amended this requirement so that

the FI is now required to report only that the account was closed.

***Observation:*** *Many FIs overwrite account holder information when there is a change in circumstances or an account is closed and do not retain legacy data. Together the clarification on how to report changes in residency during the year and the removal of the need to report balances for closed accounts will simplify the system and process changes for many FIs.*

**13. Expectation that account holders are informed that they will be reported**

The Commentary provides in several instances that it is expected that an FI informs account holders that their information will be reported. Upon request, FIs are expected to make available to account holders the details of the data that is reported to the government. FIs may inform account holders either in a personalized manner or in general terms and conditions.

*Compliance*

**14. The account holder remains responsible for determining its tax residencies**

The Commentary clarifies that the account holder is responsible for determining in which countries or jurisdictions it is a tax resident. The OECD and participating governments will make efforts to provide guidance to taxpayers that are unsure of their tax residency.

***Observation:*** *This provision eliminates a potentially significant area of complexity for FIs, as determining a client's 'tax residency' is not part of the normal business of a FI.*

**15. Fines and penalties for account holders that provide false self-certifications**

The Commentary provides for an expectation that jurisdictions will adopt measures imposing sanctions for signing (or otherwise positively affirming) a false self-certification. Furthermore, the Commentary expresses that jurisdictions may introduce legislation that makes the opening of a new account conditional upon the receipt of a self-certification in the course of the account opening procedures.

***Observation:*** *FIs do not currently have the ability to force account holders to provide a self-certification. As such, governments implementing measures to impose fines or other sanctions on account holders failing to provide the appropriate documentation are beneficial for both FIs and for governments. The introduction of the requirement that a self-certification must be obtained in the course of the account opening procedures will lead to amongst others the training of front-office personnel of FIs.*

**16. Enforcement**

The Commentary recommends that governments implement local legislation and administrative procedures which ensure the effective implementation of CRS through laws that:

- prevent any FI, person or intermediary from adopting practices to circumvent CRS,
- requires FIs to keep records of steps undertaken and any evidence relied upon for the performance of the due diligence rules set out in CRS, and
- requires adequate measures for governments to obtain the records described above.

Furthermore, governments must have rules and administrative procedures in place to:

- follow-up with FIs when undocumented accounts are reported, and
- ensure that the entities and accounts defined in domestic law as non-reporting FIs and excluded accounts continue to have a low risk of tax evasion.

Governments should also have procedures in place to periodically verify the compliance of reporting FIs. This may be part of a regular tax audit or may be a separate enquiry or review. Lastly, fines and penalties may be imposed on FIs for non-compliance with CRS.

***Observation:*** *FATCA employs withholding as an enforcement mechanism on non-participating FIs and non-compliant account holders. Without similar provisions, CRS enforcement will be achieved through the imposition of penalties under local legislation and yet to be defined compliance activities carried out by the relevant local authority. With this in mind, it is important that FIs are able to demonstrate that they have proper procedures and the appropriate audit trails in place. In turn, it is anticipated that governments will be reviewed by the OECD Global Forum peer review on their compliance with CRS.*

## *The takeaway*

The release of the CRS Commentary provides a number of clarifications necessary to assess organizational impact, and firms can now begin the required work to prepare for its implementation.

Approximately 40 countries should be ready to formally agree on CRS implementation and start local legislative procedures by the end of

2014. Thus, institutions should begin to mobilize for CRS compliance to implement revised client identification procedures by January 1, 2016 and to report, at least in early adopter countries, in 2017.

Certain institutions that have managed to escape the grasp of FATCA will be abruptly brought back to meet requirements for enhanced due diligence and reporting, which will present many previously avoided operational issues. However, there is an opportunity to benefit from previous various lessons learned by the industry to pursue more efficient approaches to CRS implementation.

For larger financial institutions, the ability to leverage resources, activities and infrastructure related to the existing FATCA and US Qualified Intermediary programs will enable smarter and more efficient implementation of CRS. Finally, financial institutions of all sizes will need a strategic approach in order to accommodate the inevitable local law variations as participating jurisdictions will join over time.

## *Additional information*

***OECD publications:***

The OECD announcement on the Common Reporting Standard
The Common Reporting Standard as published
The Commentary to the Common Reporting Standard
Declaration on Automatic Exchange of Information in Tax Matters

***PwC Tax Insights regarding CRS:***

Soon to be released 'Common Reporting Standard' promises new FATCA-type obligations around the world
OECD publishes Common Reporting Standard documents

## *Let's talk*

For more information regarding the Common Reporting Standard, please contact the following members of PwC's Global Information Reporting Network. To view contacts for over 70 countries worldwide, click here:

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