

# ***Soon to be released 'Common Reporting Standard' promises new FATCA-type obligations around the world***

*January 9, 2014*

## ***In brief***

The starting date for various obligations under the Foreign Account Tax Compliance Act (FATCA) is July 1, 2014. Some associate this date with a long and weary process that started back in 2010 with the passage of the United States HIRE Act, but it also marks a milestone in the ever increasing movement towards greater tax transparency. Even before this date, another significant milestone is set to occur – the release of the Common Reporting Standard (CRS) in February 2014 by the Organisation for Economic Co-operation and Development (OECD). Like US FATCA, the CRS will require financial institutions around the globe to play a central role in providing tax authorities with greater access and insight into taxpayer financial account data including the income earned in these accounts.

## ***OECD to present standardised model***

The [G8](#) and the [G20](#) recently charged the OECD with developing the CRS, the primary goal of which is to facilitate automatic tax information exchanges between non-US countries. In short, the CRS is intended to be a standardised, cost effective model for the bilateral automatic exchange of tax information (including creating common due diligence procedures). The transparency created by the CRS is meant to be yet another deterrent to taxpayers' use of offshore financial accounts (held directly or indirectly) to avoid domestic tax liabilities.

The CRS is expected to build upon the US FATCA regime and will be based on the intergovernmental agreements (IGAs) entered into between the US and its partner countries (US FATCA IGAs) to implement US FATCA. It also may include similar detailed due diligence procedures with respect to both new and pre-existing accounts. The CRS model will serve as the starting point for participating countries to negotiate IGAs (hereinafter referred to as CRS IGAs), similar to the US FATCA IGAs that the United States is pursuing. In effect, the CRS will support the creation of US FATCA-like programs with a number of jurisdictions already set to pursue CRS IGAs with each other.

Similar to the US FATCA regime, those countries negotiating CRS IGAs may be required to enact domestic legislation. According to the OECD, this legislation should require financial institutions located in a participating jurisdiction to collect information beginning in 2015 and report it to the jurisdictional taxing authority beginning in 2016. Jurisdictions are also expected to supplement this legislation with

additional guidance regarding implementation.

The development of the CRS is not entirely unexpected. When US FATCA first emerged in 2010, some speculated that other countries would adopt a similar effort over time – the United Kingdom (UK) was the first to do so by promulgating IGAs with its Crown Dependencies (Isle of Man and Channel Islands) and Overseas Territories (so-called UK FATCA). With respect to the CRS, it already enjoys a global level of support from at least 40 jurisdictions (see [November 28, 2013 joint statement](#)).

### **Potential impact to existing FATCA compliance programs**

Companies currently working to be US FATCA compliant (financial groups as well as multinationals with entities subject to FATCA) will need to consider the impact that the CRS will have on their compliance plans. The scope of the CRS will likely diverge from US FATCA in various ways. As a result, it will be important for companies to maintain flexible plans to accommodate the CRS requirements that are different from the current US FATCA requirements, such as the following:

- *New and pre-existing account information.* Currently, US FATCA compliance programs include the review of client information for indicia of US status. While the requirements under the CRS will most likely be similar, the ownership information required to be reviewed is expected to increase exponentially (to account for each CRS IGA) for both new account and more particularly pre-existing account due diligence. In addition, it is expected that de minimis thresholds will not be included in the CRS and thus data

from all accounts will need to be reviewed.

- *Withholding.* While the CRS is not expected to include withholding provisions, jurisdictions becoming subject to CRS reporting may adopt local enforcement legislation as a means to improve compliance.
- *Reporting.* The CRS is expected to have a reporting approach similar to US FATCA, although it is not yet known how much divergence there will be. Some observers anticipate that certain jurisdictions may attempt to require financial institutions to provide information about their residents over and above the information required under the CRS.

Practically speaking, institutions that are getting ready for FATCA will need to expand their data model to include additional documents and the information requiring additional review. While the data should not be overly difficult to capture if an extendable and open data framework for US FATCA has been developed, the impact of tracking these additional data elements and subsequent modifications may be challenging and costly. Any resulting costs could present a surprise for 2014 forecasting purposes due to the proposed 2015 timetable.

### **In detail**

#### ***The emergence and momentum of the CRS***

##### ***US FATCA regime as core building block***

Dramatically increasing government deficits and poor economic growth have driven many governments to focus on new ways to address the resulting funding gap. Combating tax evasion is one way to collect

additional revenue without increasing taxes. The unilateral action taken by the United States to enact the US FATCA regime appears to have provided an attractive model that other jurisdictions can replicate. With the US FATCA system as a starting point, automatic tax information exchange agreements between countries promises to expand in a way that could not have been possible without such a multilateral consensus. Simply stated, some countries see the tremendous value that a US FATCA-like regime could provide and have decided to make it a tool to use for their own benefit.

#### ***Creation of the CRS endorsed by G8 and G20 countries***

Both the G8 and the G20 have asked the OECD to develop the CRS model to facilitate the automatic exchange of tax information that goes beyond existing channels. The CRS is therefore intended to improve exchanges which so far occur only via a specific request from one tax authority to another under a bilateral agreement or tax treaty.

#### ***Other tax information initiatives***

The CRS is part of a larger global trend to achieve more standardised sharing and flow of tax-related information. While not an exhaustive list, the following briefly describes two European Union (EU) endeavours as well as another related OECD project.

#### ***EU Council Directive***

The IGAs facilitating the implementation of US FATCA have served as an 'icebreaker' to extend the scope of automatic exchange of tax information agreements to EU member states. The 2011 [Council Directive on Administrative Cooperation in the Field of Taxation](#) (the 2011 Directive) contains a 'most favoured nation' clause requiring tax

information of the type shared with a third country (e.g., the US) be provided to any other EU member state. The 2011 Directive sets forth the requirement to exchange tax information in theory, however, it does not provide any guidance on a country's approach – i.e., how this exchange of information would work practically.

The Finance Ministers of France, Germany, Italy, Spain, and the UK wrote a letter to the EU Commission in April 2013 ([the April 2013 Letter](#)) outlining an initiative to develop and pilot a multilateral automatic information exchange program. The same five countries, together with the United States, had previously announced in February of 2012 the concept of IGAs to improve tax compliance and help implement US FATCA. According to these countries, this new multilateral program should be based on an IGA framework similar to US FATCA with the aim of moving towards a single global standard for the automatic exchange of tax information. Their rationale is that Model US FATCA IGAs minimize burdens on business while ensuring effective and efficient information exchange.

In June of 2013, the EU [responded](#) to the April 2013 Letter by putting forth a proposal to amend the 2011 Directive. The proposal acknowledges that the EU continues to actively pursue the implementation of the automatic exchange of tax information to combat tax fraud and evasion and that US FATCA may effectively provide a roadmap. Thus, the EU proposal appears to be running in parallel to the OECD's release of the CRS. It has been acknowledged by the EU Parliament that the CRS is technically the frontrunner to the process.

**Observation:** *The effect of these two similar efforts may be reduced*

*given that France, Germany, Italy, Spain, and the UK are also the key driving forces behind the CRS. These countries have made public statements about the need for a single global standard based on US FATCA as noted in a recent EU European Commission Memo, which states: "The latest draft of the global standard appears to meet at least most EU needs, and the OECD intends to present the final version to the G20 Finance Ministers in February for agreement."*

#### **EU Savings Directive**

The EU Savings Directive (EUSD), which has been in place since 2003, is another similar EU endeavour. The EUSD aims to counter cross-border tax evasion through the collection and exchange of information about foreign resident individuals receiving savings income outside their resident state. Current proposals to widen the scope of EUSD were not approved at the ECOFIN (Economic and Financial Affairs Council) and European Council meetings in November and December 2013, however the intention remains that "the revised Directive on the taxation of savings income will be adopted by March 2014." The proposals include the expansion of the definition of interest, paying agent, and beneficial owner to close perceived loopholes in the existing regime.

**Observation:** *While the European Council has recognised the work in respect of the CRS, no comment has been made in respect of the future of EUSD in light of this development. It may be the case that the EUSD will be modified after the CRS is released.*

#### **OECD 'TRACE' project**

In January 2013, the OECD Committee on Fiscal Affairs approved the Treaty Relief and Compliance Enhancement (TRACE) Implementation Package. So-called

TRACE involves standardised agreements and forms to be used by any country wanting to implement the so-called Authorised Intermediary (AI) system. Although not yet implemented, the AI system aims to minimize administrative barriers for claiming withholding tax relief at source on portfolio investments. The OECD has noted that the efforts regarding TRACE will need to be aligned with US FATCA and other emerging reporting regimes so as to reduce implementation costs.

#### **Expected key features of the CRS**

Although the actual CRS model has not been officially released, the OECD has described some key features of the CRS that it considers critical to its successful implementation. Two OECD releases (a June 2013 report, *A Step Change in Tax Transparency*, and the July 2013 G-20 Finance Ministers progress report) provide helpful detail for stakeholders. The following discussion highlights some of these key features and corresponding challenges:

#### **Scope of information and due diligence procedures**

The OECD proposes that jurisdictions obtain certain financial information directly from reporting financial institutions, and automatically exchange such tax information on an annual basis with their exchange partners. The information to be exchanged includes interest and dividends earned, account balances, income from certain insurance products, and sale proceeds from financial assets and other income generated by assets or from payments made with respect to a financial account. The CRS is also expected to specify the type of accountholders subject to reporting as well as the type of financial institutions required to report. It is likely that each country will specify the exceptions for the types of entities it wishes to exclude

from having to report account holders (similar to the US FATCA IGAs).

**Observation:** The financial information to be reported is expected to be the same regardless of whether the reporting is done under US FATCA or the CRS. Similar to the US FATCA regime, the general scope of the CRS is expected to include banks, and other financial institutions such as brokers, collective investment vehicles, and insurance companies.

While the primary goal of the CRS is the establishment of common global reporting procedures, the OECD believes that an effective CRS regime must have common, robust due diligence procedures. These procedures, which may be similar to Annex I of the US FATCA Model 1 IGA must properly identify reportable accounts and collect the required account holder information needed for reporting. Work on this issue has already begun as the OECD's Working Party No. 10 on Exchange of Information and Tax Compliance met several times in 2013 to discuss a comprehensive approach to the due diligence procedures.

#### *Achieving a consistent standard for implementation*

The G8 and G20 have emphasized the need for a single global standard for the automatic exchange of information. While the OECD also has stated that the creation of consistent standards and coordinating guidance should help ensure cost efficiency, the OECD has already indicated that there will likely be differences between the CRS and US FATCA. Most notably, the OECD has stated that although monetary thresholds may reduce the burden for some financial institutions, they could add complexity and omitting them from the CRS could be one significant difference.

**Observation:** Some countries may not want the monetary thresholds as they may be looking to have the relevant information for all accounts (even for smaller balances) to maximize their opportunity to tackle non-compliant taxpayers. It is no coincidence that the EUSD (described above) contains no *de minimis* threshold with EU member states being the main architects of the CRS.

The OECD also has noted that another likely difference between the CRS and US FATCA will involve tax residency and citizenship. Unlike the United States, the tax system in most countries is based solely on 'tax residency' and thus, for example, information relating to citizenship would not be needed.

**Observation:** For financial institutions that operate in multiple jurisdictions, the challenges posed by these variations will need to be addressed. This may mean that US FATCA compliance policies and procedures may need to be re-evaluated. For example, for those financial institutions that manage US FATCA based on a centralized approach, the need to identify the local variations for CRS IGAs may be challenging.

Each CRS IGA will likely require the parties to enact local legislation, which could differ not just in reporting, but in other areas such as withholding and due diligence procedures.

**Observation:** The UK is an early example of how achieving consistency may prove difficult. UK financial institutions must address not only the US/UK IGA with respect to the US FATCA regime, but also agreements with Crown Dependencies and Overseas Territories. There are differences between these agreements that represent how risk of tax evasion is viewed differently by the US and

the UK. Moreover, there are notable differences between the two pieces of proposed legislation that govern the agreements.

#### *Logistical hurdles for the automatic exchange of information*

A critical feature of the CRS is establishing a platform for enabling automatic tax information exchange relationships between countries. The OECD wants this platform to have the ability to accommodate data privacy issues, similar to how these issues were addressed in the US FATCA IGAs. This will likely occur with the enactment of local legislation.

The CRS is also expected to include a Competent Authority (CA) Agreement which will likely be used by the respective governments to reach agreement on the provisions of the CRS. Broadly speaking, a government's CA helps enforce domestic tax laws and treaties, and will also be involved with helping to resolve infringements if disputes arise. The CA Agreement under the CRS model is intended to be a mere 'executive agreement' without full treaty status (not requiring ratification by legislative bodies). As a result, the exchange of information may still require some other 'treaty basis' to be effective.

Many existing avenues may provide the treaty basis upon which the CRS could be implemented. For example, the OECD proposes using its Multilateral Convention on Mutual Administrative Assistance in Tax Matters as the platform for the CRS because it provides all possible forms of administrative cooperation between countries, contains strict confidentiality rules, and permits the automatic exchange of tax information.

### Standardised reporting platform

To function effectively, the CRS will likely require that the reporting formats be standardised so that information can be captured, exchanged, and processed quickly and efficiently by the receiving jurisdiction. Compatible technology and data standards are critical given the desire for electronic data transfers. In addition, secure and compatible methods of transmission and data encryption must be in place to ensure confidentiality.

The anticipated CRS guidance is expected to include the actual 'schema' (i.e., data model) and a user-guide to the schema. This approach may be similar to, yet somewhat different from, the [Intergovernmental FATCA XML Schema](#) released for US FATCA purposes. While a single schema for both regimes (US FATCA and the CRS) has been discussed at various instances at the OECD, currently we expect (at least) two different schema for the government-to-government exchange of information. The IRS has indicated its willingness to receive the information from those financial institutions reporting directly in the same format provided in the CRS, however, it remains to be seen what formats will be chosen by CRS-participating governments.

**Observation:** *For the past year, the OECD working teams have been developing the XML schema (i.e., data model) to reduce the complexity and variability of reporting. This is an important step to reducing cost and complexity; nevertheless, it appears that there will still be significant operational challenges whereby financial institutions will be required to have the capability to report to potentially over 40 governments, depending on their circumstances.*

### Other implementation concerns

#### Expected timeline for countries to sign agreements

The G20 are expected to approve the CRS in February 2014. After that approval, it is likely that many of the jurisdictions that have announced their support for the CRS will look to sign CRS IGAs and enact domestic legislation requiring financial institutions to collect information beginning in January 2015 and report it to their domestic tax authorities beginning in 2016.

**Observation:** *According to its website, the US started 2014 with fewer than 20 FATCA IGAs in effect – an indication of the challenges of getting these types of agreements signed. With only months remaining until US FATCA withholding starts, companies will have to address their US FATCA compliance with uncertainty for those jurisdictions in which no agreement has yet been signed, hampering their ability to plan for obligations in those jurisdictions. Moreover, jurisdictions will undoubtedly face difficulty meeting this timeline given their limited resources and having to negotiate on multiple fronts.*

#### Participation from all regions

Absent from the list of 40 jurisdictions that have committed to adopt the CRS are jurisdictions in Asia and the Middle East. In addition, this list includes only two South American countries. The lack of participation from these regions is consistent with the challenges that the United States has been facing with respect to negotiating US FATCA IGAs so far. Other than Japan, the United States has not yet signed any US FATCA IGAs with countries from Asia, South America, or the Middle East.

**Observation:** *Financial institutions will need alternative strategies to*

*respond to developments in nonparticipating regions. They will also need to be mindful that, as with US FATCA, despite the signing of a CRS IGA, local regulations will likely need to be in place before they can act.*

#### No withholding is contemplated

The OECD has not stated that the imposition of withholding (similar to the US FATCA regime) will be a key feature of the CRS model, nor has it suggested penalties for those entities or individuals that do not provide the required information. Rather, the focus is on financial institutions providing more in depth information than the governments currently receive.

Without significant numbers of CRS IGAs in place covering all areas of the globe and without withholding or alternative measures to encourage participation, the risk is that financial accounts that are hidden offshore will be merely relocated to a jurisdiction where this type of agreement is not in place.

**Observation:** *The participating governments will need to ensure that this information is turned into knowledge of tax evasion and appropriate compliance activity is undertaken. There is evidence that where there is an increased level of tax information reporting, voluntary compliance by taxpayers increases. However, this may be short-lived if not supported by a rigorous compliance program. Certain jurisdictions may ultimately decide to implement withholding on local source income or other potential penalties as yet another way to encourage compliance.*

### The takeaway

#### Preparing now for the CRS

Financial institutions, as well as multinational companies that have

affected entities, are working towards compliance with the US FATCA regime. The emergence of the CRS model has been a relatively new development, but nonetheless promises to affect many entities already preparing for US FATCA. Unfortunately, the CRS promises to broaden the scope of compliance obligations these entities will face worldwide. As such, current US FATCA compliance plans must be flexible enough to accommodate these potential new obligations.

The timing of when these additional obligations may begin is a critical concern to a variety of stakeholders. There is a strong likelihood that CRS IGAs will be signed in 2014 and reporting is expected to begin in 2016 (with respect to information gathered in 2015.) Local taxing authorities may find this compressed timeline to be aggressive, given their need to implement a new reporting regime. Notwithstanding, stakeholders should consider proactive actions now to prepare. These include, but are not limited to:

- *Expanding US FATCA compliance plans.* Due diligence, on-boarding, and reporting processes under an entity's current US FATCA model will need to be evaluated and refined. For example, a likely result is that the underlying data model supporting US FATCA compliance will need to be significantly expanded, particularly with respect to ownership information of accounts. The potential lack of de minimis thresholds may also cause expansion of data elements required to be searched. Necessary changes to a company's current FATCA compliance plan to accommodate the CRS may be challenging.

- *Monitoring the release of the CRS model.* The details of this new model regime are needed to finalize any compliance plans. Although the CRS builds on US FATCA's principles, the differences between the two may be significant and should be a primary point of consideration.
- *Evaluating overall compliance responsibility.* The placement of compliance responsibilities for US FATCA within an organization may have been based on a more centralized or business unit approach. However, the prospects of multiple CRS IGAs between non-US jurisdictions should be taken into account. Where should management of these new compliance responsibilities occur? As an initial step, companies should consider forming an in-house project team to consider the impact of these new agreements.
- *Tracking compliance requirements on a country-by-country basis.* Similar to the release of US FATCA IGAs, there will be a need to track the CRS IGAs. In addition, tracking of the enactment of local legislation and issuance of guidance and the resulting variations will be necessary.
- *Quantifying cost estimates for budget purposes.* There have been varying estimates about the cost of implementing US FATCA to financial institutions and other entities even before considering the impact of the CRS. Companies should prepare a rough estimate of potential financial costs and required resources for the next several years. While the OECD has expressly noted a desire to minimize related costs, stakeholders may be concerned about substantial costs to address these new obligations.
- *Preparing a global risk assessment.* Companies may wish to review where they have substantially affected operations as well as the countries in which they are likely to have greater CRS and FATCA compliance obligations. Which countries may prove more difficult or costly? This evaluation may help to identify those countries in which more significant resources and planning may be necessary.
- *Identifying opportunities to provide input on local implementation.* The OECD is under enormous pressure to release the CRS model in February 2014. Thereafter, countries enacting the corresponding local legislation and issuing related guidance may provide opportunities for stakeholders to comment. Further, the OECD has invited all interested parties to submit their comments for the OECD to consider in its commentary on the CRS to be finalized in June 2014. Companies may wish to take advantage of these opportunities and consider providing input.

## **Let's talk**

For more information on how FATCA and the CRS might impact you, please contact a member of the Global GIR Network. To view contacts for over 70 countries worldwide, click [here](#).

## **Additional information**

For additional information regarding FATCA guidance and implementation, please click [here](#) for the *Global IRW Newsbrief* and *Tax Insights from Global Information Reporting* archive.