OECD Common Reporting Standard

A global FATCA-like regime

Executive Summary

On 13 February 2014, the Organization for Economic Co-operation and Development (OECD), at the request of the G8 and the G20, released a model Competent Authority Agreement (CAA) and Common Reporting Standard (CRS) designed to create a global standard for the automatic exchange of financial account information.

The publication of the CAA and the CRS is a significant structural step in governments' efforts to improve cross border tax compliance. This follows a raft of tax compliance legislation such as the US Foreign Account Tax Compliance Act (FATCA) and active campaigns of voluntary disclosures and legal procedures, most recently in Germany and Italy.

The CRS represents another global compliance burden for financial institutions and increases the risks and costs of servicing globally mobile wealthy customers – an otherwise attractive customer segment.

The good news for financial institutions is that the OECD has modelled the CRS on FATCA, which means it should be possible to leverage existing and planned FATCA processes and systems. However, the data required is different, and the volume of reporting required is likely to be significantly greater under the CRS.

The standard has no direct legal force but it is expected that jurisdictions will follow the model CAA and CRS closely when implementing bilateral agreements.

There is significant political will to implement this standard, with more than 40 jurisdictions signing up for early adoption. The expected timeframe could see jurisdictions seeking to sign agreements in 2014, with new customer due diligence procedures required in 2015 and reporting in 2016.
Although there is further detail to come, financial institutions may wish to consider the impact of the CRS on their approach to FATCA compliance, as well as the best way to engage with prospective competent authorities.

Presenting the new standard, OECD Secretary-General Angel Gurría said:

“This is a real game changer. Globalisation of the world's financial system has made it increasingly simple for people to make, hold and manage investments outside their country of residence. This new standard on automatic exchange of information will ramp up international tax co-operation, putting governments back on a more even footing as they seek to protect the integrity of their tax systems and fight tax evasion.”

Overview

Building on FATCA

The CAA and CRS are closely based on the FATCA Model 1 Intergovernmental Agreement (Model 1 IGA) with certain amendments to remove US specificities and build on work already performed as a result of FATCA. The aim is to reduce tax evasion by taxpayers using offshore financial accounts held both directly and indirectly through enhanced information reporting.

The CAA and CRS reflect the approach described in the OECD report of 18 June 2013 (A Step Change in Tax Transparency).

Reporting financial institutions will report financial account information on certain account holders to their national tax or other competent authority. These will, in turn, provide information to other competent authorities in a partner jurisdiction under a systematic and periodic transmission of “bulk” taxpayer information - an “automatic exchange” of information. The information to be exchanged will cover all types of investment income. This will include interest, dividends, income from certain insurance contracts and other similar types of income, as well as account balances and sales proceeds from financial assets.

Structure of the standard

The CAA is a base agreement. It sets out general definitions, the obligations of the jurisdictions to obtain and exchange information, and the procedures for

Key points

- The OECD’s model CRS, based on the FATCA Model 1 IGA, is designed to be a standardized approach to identifying and reporting information about taxpayers by financial institutions that will be exchanged with residence jurisdictions.
- A significant number of jurisdictions are looking to sign agreements in 2014. This could mean new customer due diligence procedures being required as early as 2015 with the first reporting being due in 2016.
- It is unlikely that all jurisdictions intending to participate will be able to enter into agreements under the same timeframe, leading to a staggered approach to implementation.
- Due to the increased scope and volume of information required by the CRS, financial institutions may need to reconsider their approach to FATCA compliance to accommodate the new standard.
- Commentary is not expected to be released until the summer of 2014. Significant uncertainties remain about the detailed requirements.
- Determining tax residency can be complex, and financial institutions will want to see competent authorities providing clear guidance to help clients determine their tax residency.
collaborating on compliance and enforcement. The annex to the CAA is the CRS, which describes the due diligence requirements for identifying and reporting on specific types of accounts under the agreement, and provides additional definitions.

The overall process for obtaining customer classifications is broadly the same as the Model 1 IGA but the nature of those classifications is based on residency rather than citizenship or nationality. This is because the OECD has recognized the investment in FATCA by the financial industry and should mean financial institutions can leverage a significant amount of the work already performed when complying with this new standard.

**Expected timing for adoption of the standard**

The next step is for the CAA and CRS to be formally submitted by the OECD to the G20 Finance Ministers and Central Bank Governors meeting in Sydney on 22-23 February 2014. At that time, it is expected there will be a public statement of support from a number of jurisdictions and that this statement will set out indicative timelines for putting in place CAs. This could see a short timeline for adoption, and might even result in the first reporting being due as early as 2016.

Adoption of the standard by partner jurisdictions will be in two phases. A competent authority will need to implement the CRS into local law. This local law would require financial institutions to collect and report data relating to account holders. At this stage many authorities are expected to provide guidance on local interpretation. Further, jurisdictions will need to agree to the CAA to facilitate the automatic exchange of information. This may be done bilaterally, through existing treaties, or through the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, a multilateral tax information exchange instrument.

**Further guidance on interpretation**

Independently of the adoption of the CAA and CRS, the OECD will continue to develop the commentary to accompany the CRS as well as the technical solutions to implement the actual information exchanges. The commentary will be of crucial importance in terms of providing sufficient guidance and explanation to allow financial institutions to interpret the CRS. It is currently expected that this commentary will be released in time for the September G20 Finance Minister meetings.

A significant concern will be whether jurisdictions will take different positions in terms of interpretation. The industry hope is that any such differences are few and far between. An additional concern, given the potential number of adopting jurisdictions, will be how financial institutions will track such differences. One possible route could be for the OECD commentary to record any differences in interpretation. This approach would allow financial institutions to look to one point of reference.

The OECD Background Information Brief released at the same time as the CAA and CRS acknowledges this concern and states that the standard will be a "living system" and so may need to "evolve over time." Helpfully the OECD also notes that "The OECD, working with G20 jurisdictions, will seek to ensure that the standard remains a single standard also over time and that as much as possible it continues to be interpreted and operated consistently across different jurisdictions."

It is also worth noting that the CAA is only a model and, before coming to an agreement, jurisdictions are able to negotiate amendments to it. Therefore, financial institutions need to make a judgment regarding the point at which the requirements are incorporated into their operations – given that they have to balance external legal milestones with internal implementation lead times.
Detailed discussion

General provisions

The CAA is intended to be executed within existing legal frameworks, such as the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. However, alternative frameworks, such as Tax Information Exchange Agreements (TIEAs), the Nordic Convention or, within the European Union, Directives, may also be used.

The CRS will need to be incorporated into domestic law by an adopting jurisdiction. As noted above, this may result in different interpretations of the CRS in different jurisdictions. Any failure to comply would be managed under local law.

The CRS is applicable to reporting financial institutions. This definition is quite wide and, like FATCA, covers custodial institutions, depository institutions, investment entities and specified insurance companies unless they present a low tax evasion risk and are excluded from reporting. Non-reporting financial institutions include:

- Government entities, international organizations and central banks;
- Broad participation retirement funds, narrow participation retirement funds, qualified credit card issuers and pension funds of government entities, international organizations and central banks;
- Entities that present a low risk of tax evasion and have certain characteristics (such entities will be defined by local law);
- Exempt collective investment vehicles
- Trusts, if the trustee is a reporting financial institution that reports all necessary information on behalf of the trust.

It is worth noting that some of the low-risk financial institutions carved out of FATCA as registered deemed compliant (such as local financial institutions e.g. some building societies in the UK) are not carved out under the CRS. Therefore, some organizations that have not had to take steps to comply with FATCA will have to do so under the CRS.

The list of accounts covered by the CRS is similar to FATCA and includes depository accounts, custodial accounts, cash-value insurance contracts, annuity contracts and certain equity or debt interests in a financial institution. There are specific classes of account that are excluded from the definition, including certain retirement or pension accounts, certain tax favored savings accounts, certain life insurance contracts, estate accounts and other accounts that present a low risk of being used to evade tax (which will be defined by local law).

The CRS will impact a greater number of accounts than FATCA. Instead of purely identifying US citizens or residents, a financial institution will be required to identify the residency of all their reportable customers. In addition, many of the de minimis limits under FATCA are not contained in the CRS. Financial institutions will therefore be required to report significantly higher volumes of information to their competent authority. This means that
financial institutions may need to reappraise their approach to compliance – particularly where a “tactical” rather than “strategic” solution has been adopted for FATCA.

As with the Model 1 IGA, the penalties for non-compliance are determined under local law. However, the OECD models do not provide for any form of withholding tax in the event that a financial institution is in a non-reporting jurisdiction.

The incentive for governments to sign up for the standard will allow the ability to access information. In addition, jurisdictions may not wish to be seen as non-compliant in terms of their ability and willingness to automatically exchange information.

Jurisdictions that do not have existing automatic information collection and exchange utilities may face some implementation challenges as they lack necessary infrastructure and so will need to invest in processes and systems to be able to receive, sort and transmit data to partner jurisdictions.

Generally, information will be exchanged between the competent authorities within nine months after the end of the calendar year. Therefore, this information will need to be reported by financial institutions significantly earlier than this. It is, however, left to each jurisdiction to define the timeframe for reporting by financial institutions.

The information to be reported includes the name, address, taxpayer identification number (TIN), date of birth (for individuals), account number (or functional equivalent), account balance or value, gross amounts paid to the account in the year, and total gross proceeds paid or credited to the account.

**EY comments**

The timeframe for reporting is in line with the Model 1 IGA. However, the requirement to report an individual’s date of birth is additional to the requirements of the Model 1 IGA. It is worth noting that, for pre-existing accounts, this information is only required to be reported if it has already been collected by a financial institution. However, institutions will need to use “reasonable effort” to obtain the information if it is not already held. It is hoped that the commentary will provide guidance as to what ‘reasonable efforts’ in this context means and how a financial institution can demonstrate this.

### Key points

- Some of the low risk financial institutions carved out of FATCA are included in the scope of the CRS.
- The number of customers and accounts required to be reviewed and reported is likely to be greater than FATCA due to the multi-lateral approach and lack of some of the *de minimis* carve outs.

### Information to be reported and exchanged

Under the terms of the CAA, the partner jurisdictions agree to exchange information on account holders which have their tax residence jurisdiction in the other jurisdiction.
Due diligence requirements

The due diligence requirements applicable to financial institutions are set out in the CRS.

The due diligence requirements distinguish between pre-existing and new accounts and between individual accounts and entity accounts. For all accounts, financial institutions may not rely on certifications or documentary evidence if the financial institution (or, in the case of certain high-value accounts, a relationship manager) knows or has reason to know the certification or documentary evidence is incorrect or unreliable. This will require financial institutions to have processes to cross-validate information received against the information held for Know Your Customer / Anti-Money Laundering purposes.

1. Pre-existing individual accounts

The CRS does not define the date when an account is to be classified as a pre-existing account, leaving this to the jurisdictions entering into the agreement. It does, however, distinguish between high-value accounts (over $1m in value on the last day of any calendar year) and lower-value accounts.

For pre-existing lower-value accounts, if a financial institution has a current residence address for an account holder, it may treat the account holder as tax resident at that address. If no such address is held, a search of electronic records for one of six defined indicia must be performed.

The CRS provides the indicia that would be considered as indicating the account holder is a resident for tax purposes of a reportable jurisdiction. The indicia are:

a) Identification of the account holder as a resident of a reportable jurisdiction;

b) Current mailing or residence address (including a post office box) in a reportable jurisdiction;

c) One or more telephone numbers in a reportable jurisdiction and no telephone number in the jurisdiction of the reporting financial institution;

d) Standing instructions (other than with respect to a depository account) to transfer funds to an account maintained in a reportable jurisdiction;

e) Currently effective power of attorney or signatory authority granted to a person with an address in a reportable jurisdiction;

f) A “hold mail” instruction or “in-care-of” address in a reportable jurisdiction if the reporting financial institution does not have any other address on file for the account holder.

For pre-existing high-value accounts, a paper records search for these indicia and a relationship manager inquiry are also required. However, such a paper-based search is not required if the electronic record contains sufficient information in electronically searchable format to cover all the indicia.

If any of the indicia are found, the financial institution will be required to treat the account holder as a resident for tax purposes in each identified jurisdiction, unless it elects to solicit the required documentary evidence to rebut the residency status.
The deadline for completion of the indicia review is not defined by the CRS. For subsequent years, any account that becomes a high-value account must have the relevant review completed within the calendar year following the year in which the account became a high-value account. Once the review is complete, no further action will be required until there is a change of circumstances.

EY comments

As there is no standardized start and end date for the enhanced file review, each new agreement entered into could require a new paper records search on a different set of accounts. There is significant concern by industry about this requirement. One possible solution may be for each jurisdiction to set a fixed date on which accounts can be classified as pre-existing. Financial institutions could then complete a single review and report all relevant information to the competent authority. Then, as new agreements are signed, the competent authority will already have the information required to be reported.

Another option for eliminating the potential for multiple paper record searches is for a financial institution to hold all relevant indicia data in electronically-searchable fields. This may require some financial institutions to perform a single-paper file review to ensure all relevant information is recorded in the required format but thereafter it should be possible for electronic searches to be relied on for all customers.

In either case, it may be possible to consolidate file reviews with those required for FATCA.

There is no de minimis rule under the CRS. However, the CRS does include an exemption from the electronic indicia search for pre-existing lower-value accounts when a residence address is held. This approach is very welcome, as most financial institutions will be able to make use of this exemption and will not be required to determine the tax residency of the individual. This should dramatically reduce the number of pre-existing accounts that need to be subject to a full indicia review.

The indicia in the CRS are slightly different to those in the Model 1 IGA. For example, the telephone number indicia has been amended to include the requirement that there are no other telephone numbers in other jurisdictions, and standing instructions from depositary accounts are excluded. This will cause operational complications for financial institutions when complying with both FATCA and the CRS.

Telephone numbers are likely to be problematic in practice and could generate false positives. For example, a resident of one jurisdiction may work in another jurisdiction and so only provide a telephone number in that other jurisdiction. Complications may also arise where financial institutions hold only third-party associated telephone numbers of investment advisors or agents, who may be resident in a third jurisdiction.

Key points

- The ability to rely on a residential address should counteract the removal of the de minimis threshold and reduce the number of pre-existing customers who need to be contacted.

- Depending on developments, it may be possible to identify opportunities to consolidate remediation efforts with that required for FATCA, particularly for high value accounts.
2. New individual accounts

For new individual accounts, the CRS requires the financial institution to obtain a self-certification from the account holder in order to determine where the individual is tax resident. The financial institution must then confirm the reasonableness of the self-certification based on the information obtained by it in connection with the opening of the account, including any documentation collected pursuant to AML/KYC procedures. Once the review has been completed, no further action is required until there is a change of circumstances.

EY comments

These requirements are very similar to the requirements under the Model 1 IGA, except that account holders must provide details of their tax residence (rather than citizenship or nationality) and date of birth as part of the self-certification.

The de minimis threshold has been removed, so all new accounts must be classified and, if necessary, reported.

The rules for determining tax residency vary significantly between jurisdictions and can quickly become very complex. The potential complexity is illustrated by the UK tax authority’s (HMRC) Guidance Note: Statutory Residence Test. Key to successful implementation of the CRS will be jurisdiction-specific guidance capable of being understood by the average lay person. While we believe there will be no substitute for a detailed guidance, jurisdictions should be encouraged to produce a flowchart (similar to that on page 9 of the UK guidance) and/or an online “Tax Residency Indicator” tool to aid customers in determining their residence. Without such guidance, financial institutions may have concerns about the level of support or guidance they will be able to give clients who may have questions regarding residence.

Clarity will be needed around what financial institutions should do if an individual changes tax residency during a reportable period or potentially has multiple residencies.

In order to facilitate reporting to the relevant competent authority, a “date of birth field” may be required by financial institutions in their customer information systems.

The CRS does not specifically consider the position where a pre-existing customer is opening a new account. This is also not specifically covered under the Model 1 IGA (instead is covered in the related guidance). It is anticipated that the commentary to the CRS will take a similar approach.

3. Pre-existing entity accounts

For classification of entity accounts, the CRS focuses on self-certification and other information, such as that collected for local Anti-Money Laundering/Know Your Customer purposes. However, a de minimis threshold of $250,000 applies, below which pre-existing entity accounts do not need to be classified. If the account balance exceeds this value in subsequent years, a classification will then be required.

Key points

- As tax residency is such a complex issue, local guidance will be required to increase the accuracy of self-certifications
- The lack of a de minimis threshold will significantly increase the number of customers who will need to be classified and reported
If a pre-existing entity account is held by a non-financial entity (NFE), a financial institution will be required to determine if the entity is active or passive. If the entity is a passive NFE, the financial institution will be required to identify the “controlling persons” of such an entity and to determine the residency of such persons. The identification of the controlling persons can be done through a review of documentation obtained under existing AML/KYC procedures. In determining the residency of the controlling persons, for accounts with a value of less than $1m, the financial institution may rely on information collected under its AML/KYC procedures. For accounts with a value of over $1m, a self-certification on behalf of the NFE will be required. If any controlling person of the NFE is a resident of another jurisdiction, the account is to be treated as an account of that jurisdiction.

As for individual accounts, the CRS does not define the date when the classification of pre-existing entity accounts needs to be completed. However, once the classification has been completed, no further action is required until there is a change of circumstances.

EY comments
These requirements are very similar to the requirements under the Model 1 IGA. The most significant difference is the application of the de minimis threshold. Under the CRS, if the value of a pre-existing entity account is initially below the de minimis threshold, the account becomes within scope as soon as the value exceeds $250,000, whereas under the Model 1 IGA the account value would need to exceed $1m.

Under the CRS, if the entity that holds the account is an investment entity from a jurisdiction that has not signed up to the CRS, it must be classified as a passive NFE. This is a significant departure from FATCA, and will require financial institutions within CRS jurisdictions to get information on the controlling persons of any investment entity outside a CRS jurisdiction that is an account holder.

4. New entity accounts
For new entity accounts, the financial institution will be required to determine the entity’s status. A self-certification of the entity’s residence is required. The financial institution may then treat the account holder as a financial institution or active NFE if the account holder is generally known as such. In all other cases, the account holder must provide a self-certification of its classification.

Once the entity has been classified, no further action is required until there is a change of circumstances.

EY comments
These requirements are very similar to the requirements under the Model 1 IGA and so, in principle, any processes in place to ensure compliance with the Model 1 IGA should require minimal change. However, the volumes will be greater and that may have a systems/process impact.

Key points
- As for new individual accounts, the lack of a de minimis thresholds will mean all entity customers will need to be classified
- Although the requirements are very similar to FATCA, the number of entities that operate cross border is significantly higher outside the US, so the volume of reporting will be greater
Implications

Difficulties in creating a standardized approach

The CRS relies heavily on local AML and KYC requirements. As these requirements vary across jurisdictions, international financial institutions may face difficulties standardizing their approach. This may be exacerbated by differences in the final CAA's agreements that are entered into between jurisdictions, as well as differences in local implementation.

To aid successful implementation across multiple jurisdictions, a central record of all variations from the model CRS would help large financial institutions become compliant. Further difficulties in standardizing an approach to customer classification will arise because of differences between the CRS, FATCA, the European Savings Directive (EUSD) and, should the proposed amendments be agreed upon, the Directive on Administrative Cooperation (DAC).

We have seen with FATCA that, agreeing and implementing IGAs is a time-consuming process. That experience suggests it may be unlikely that all jurisdictions intending to participate will be able to enter into and implement agreements in the same timeframe.

Difficulties in implementation

The CRS relies heavily on self-certification by customers. Financial institutions are required to assess the reasonableness of those self-certifications based on any other information collected for the customer. However, the laws regarding tax residence are complicated, and are different in different jurisdictions, implementing an effective validation process may not be straightforward.

Scope of implementation

As mentioned above, over 40 jurisdictions have signed up to early adoption. However, the list of jurisdictions is heavily dominated by Europe, with Asia and Latin America particularly underrepresented.

Financial institutions may wish to consider putting in place at early stage policies to deal with clients who may wish to move their accounts to a non-CRS jurisdiction.

Industry specific issues

Asset Management

Removal of regularly traded investment entities exemption: Under the CRS the definition of financial account includes interests in funds that are regularly traded on a stock exchange. This means that exchange traded funds in jurisdictions that adopt the CRS will be within the scope for reporting under the CRS but are not within the scope of reporting for FATCA.

As a consequence, it seems that governments will need to implement legislation that will enable investment entities that issue shares on an exchange to perform the due diligence obligations required under the CRS.

Impact on Investment Entities from jurisdictions not adopting the CRS: In contrast to FATCA, investment entities from jurisdictions that have not signed up to the CRS will be classified as passive NFEs. This will require financial institutions in jurisdictions that have signed up to the CRS to classify the controlling persons of any fund outside a CRS jurisdiction that holds an account.
Commentary and guidance

**Industry specific issues**

**Insurance**

**Cash value insurance (CVI):** the definition of CVI in the CRS is helpful, as it largely follows FATCA in distinguishing between savings and protection products. In particular the exemption for government sponsored products such as pensions (an Annex II concept under the Model 1 IGA) is maintained. There is also an additional exemption for payments made as a return of an advance premium or premium deposit for certain insurance contracts, although we do not expect it to have a significant effect on scope.

**Pre-existing individual accounts:** unlike the Model 1 IGA, the CRS does not provide an exemption from review for an existing book of business and there is no de minimis threshold. This therefore represents a significant increase in the compliance burden on insurers as, under FATCA, the existing book of business is largely exempt from review and, where it is not, a $250,000 de minimis applies. Under the CRS, although financial institutions can rely on existing residency addresses for pre-existing low-value (less than $1m) individual accounts, this still requires a review of and potential reporting on the existing book of business. If no residency address is held, there is currently very little guidance around the implementation of the CRS. Draft guidance is due to be developed by the OECD working party, with the next meeting to take place in March. It would be helpful if a number of items could be specifically discussed in the guidance commentary, such as the definition of what constitutes “reasonable effort” when a financial institution is trying to obtain a TIN and date of birth for pre-existing accounts. The industry is lobbying hard for clarification of this and other similar terms to be provided. Further analysis will need to be performed once the commentary is released.

As can be seen from the implementation of the Model 1 IGA, local guidance is critical to understanding the practical implications of the CRS in a local environment.

**Next steps**

- The approach adopted by financial institutions will be influenced by, among other things, the extent to which they consider that the anticipated timetable for implementation of the OECD proposals may change. Currently the anticipated timeline appears ambitious. In any event, as the CRS is a model agreement, the requirements are subject to change, both in terms of the final agreements that are entered into and the interpretation, local legislation and guidance provided at a country level.

- Financial institutions will need to decide the best time to initiate a change program to ensure it can satisfy the requirements of the CRS, taking into account, in particular, the time required for implementing changes to its customer classification processes.

- However, financial institutions may want to take steps now to understand the key differences and similarities between the CRS and FATCA, and the corresponding impact on their approach to FATCA compliance. For example, there may be opportunities to reduce effort by combining FATCA planned activities with the CRS, such as the review of high value accounts.

- Financial institutions may also wish to consider the best approach to engaging with prospective competent authorities to help ensure that businesses can comply with the CRS in a way that minimises cost and disruption.
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