

17. Automatic Exchange of Information: The Common Reporting Standard

Ronald Wyss and Dr. Beat Baumgartner, Loyens & Loeff
Switzerland, Zurich



1 Introduction

Exchange of information between countries is seen as critical in the fight against tax evasion. This is why the OECD has developed a global standard for the automatic exchange of financial account information: the “Common Reporting Standard” (CRS).

Under CRS, financial institutions, including many parties in the asset/investment management industry, are obliged to identify their clients, determine their country of residence and report financial information to the local authorities. Such financial information is automatically exchanged with the country of residence of the account holders on an annual basis.

This article provides for a brief explanation of the CRS concept and is written in particular as an introduction into CRS for the Swiss investment/asset management industry.

2 Statutory Framework

Since its adoption in 2015 by the OECD (and endorsed by the G-20 in the same year), around 90 countries, including Switzerland, have committed themselves to implementing CRS by signing a “multilateral competent authority agreement” (MCAA). This agreement will form the basis for the automatic exchange of information under CRS. The number of ‘CRS participating jurisdictions’ is expected to increase further in the coming years. The CRS concept is largely based on the Intergovernmental Model Agreements (IGA or IGAs) which are concluded in the framework of the US Foreign Account Tax Compliance Act (FATCA).

In the EU, a harmonized implementation of CRS is organized by way of the EU Directive on Administrative Cooperation. Switzerland has not only adhered to the CRS standard by signing the MCAA, but also by agreeing with the EU on automatic exchange of financial account information in an amendment to the savings tax agreement concluded with the EU. Switzerland will implement CRS as of January 1, 2017 (reporting in 2018 on 2017 data). Draft legislation has already been published.

3 The Information to be Reported

CRS is about obtaining financial information on reportable accounts and concerns all types of investment income (interests, dividends, etc.), as well as account balances and sales proceeds from financial assets, capital and income from capital invested in/via, or placed with, a foreign entity.

4 Entities that Must Report

4.1 General

CRS draws a distinction between financial institutions and non-financial entities. This distinction entails that, in fact, each entity must itself verify whether it is a financial institution or not. Identification and reporting requirements are imposed on entities that qualify as financial institutions. In addition, certain non-financial entities are required to disclose information about their controlling person (disclose the identity of the ultimate beneficial owner).

4.2 Financial institution

4.2.1 General

The definition of financial institution for CRS purposes is very similar to FATCA and comprises, inter alia, banks, custodians, certain specific insurance companies, but also ‘investment enti-

ties’. Below, we will solely focus on ‘investment entities’, as this is the category that is likely to raise many questions in the asset/investment management industry.

4.2.2 Investment entity

Under CRS an ‘investment entity’ is an entity which has as its primary business activity the performing for or on behalf of a client one or more of the following activities or transactions:

- i. trading in securities, money market instruments; FX/interest instruments, derivatives, etc.;
- ii. individual and collective portfolio management; or
- iii. otherwise investing, administering, or managing financial assets or money on behalf of other persons.

Also, private entities that are primarily investing and are managed by (third party) financial institutions come within the scope of “investment entities”.

Examples of investment entities are asset managers, private equity funds, hedge funds, venture capital funds and similar investment funds. Furthermore, vehicles which are managed by asset managers are, in general, considered as investment entities.

The description of the term ‘investment entity’ is very broad, which creates a great lack of clarity in practice. For example, entities which generally do not qualify as ‘investment institutions’ under most regulatory supervision regimes, may well qualify as such for CRS. For the explanation of the definition of investment entity, alignment must be sought with the recommendations of the ‘Financial Action Task Force’ (FATF)¹⁾.

Various EU countries are implementing a specific exception for family funds (family funds are not considered being an investment entity, provided a number of conditions is met.)

Further guidance will be needed on how Switzerland will implement the notion of ‘investment entities’. It can be expected that many parties in the asset/investment management industry in Switzerland will be considered a financial institution for CRS purposes. Switzerland is likely to align itself to the way in which CRS is being implemented in the main EU countries.

4.3 Non-reporting financial institutions

Certain financial institutions are exempt from reporting obligation. These are government bodies, international organizations, central banks, pension funds and certain other entities with a low risk of being used for tax avoidance. Also certain regulated collective investment institutions may, under circumstances, be exempt from their reporting obligation (e.g., an investment entity exclusively held by pension funds).

4.4 Non-financial entity

If an entity is not a financial institution, it is considered a non-financial entity for CRS purposes and not required to identify and report on account holders. An obligation, however, is imposed on some non-financial entities to identify their ‘controlling persons’ and disclose information on such controlling person to the financial institution with which it is holding an account. This is an endeavour to prevent assets from being hidden by means of a non-financial entity.

A distinction is drawn between active and passive non-financial entities. Active non-financial entities are not under the obliga-

tion to identify their controlling persons because the risk of tax evasion of those entities is regarded as low. Active non-financial entities are, for example, entities of which the gross income consists for less than 50% of passive income, entities traded on a recognized stock exchange, finance and holding companies of active groups, entities with a not-for-profit object, etc.

If a non-financial entity is labeled as 'passive' (e.g., a company owned by a sole shareholder exclusively holding passive investments), such entity will be classified as a "passive non-financial institution". The controlling persons of passive non-financial institution must be identified. CRS describes the controlling persons as the individual persons who exercise control over the entity. A controlling person is a person holding a minimum of 25% of the shares or who is able to exercise actual control over the entity. If there are no shareholders with a qualifying interest, the director of the entity will be regarded as the controlling person (even though a director does not usually have a financial interest).

5 Obligations of Financial Institutions

5.1 Identification

Based on CRS, financial institutions in the EU had to implement procedures to collect and review information on the identity and tax residence of their "account holders", be it individuals or entities. In Switzerland, these obligations will start as of January 1, 2017. A distinction needs to be made between existing accounts and new accounts (on which we will not elaborate), as well as between individual accounts and entity accounts.

The term 'account holder' is interpreted broadly, whereby, for example, a shareholder, a client or an investor in a fund may also qualify as account holders.

For all account holders that are individual persons, the tax residence must be determined. Individual persons having their tax residence in another participating CRS jurisdiction, are persons with 'reportable accounts'. Financial information on these accounts needs to be reported (see further below).

With respect to entities being account holders of a financial institution, the situation is more complex. In simplified terms it can be summarized as follows:

- First of all, financial institutions are required to determine the place of establishment of all account holders being entities. All entities established in another participating CRS jurisdiction must be considered by the financial institution as persons with 'reportable accounts' (irrespective of whether the entity is active or passive);
- Subsequently, the financial institution needs to determine with respect to all entities/account holders whether these are passive or active. Only with respect to entities labeled as 'passive', the "controlling persons" must be identified and the tax residence of such controlling persons must be determined, irrespective of where the entity itself is established (in the same country as the financial institution or in another participating CRS jurisdiction). If a controlling person of such 'passive entity' is tax resident in another jurisdiction than the country of residence of the reporting financial institution, such person must be considered to be a person with a 'reportable account'.

Certain exceptions apply to the above rules. Entities are not considered to hold 'reportable accounts', if the account holder is a financial institution itself, a listed enterprises and their affiliates, a government body, an international organisation, or a central bank.

The above means that financial institutions will need to go through the CRS identification and review process for all account holders. We expect them to also request the required information from account holders who are resident or established in a jurisdiction which is not yet party to CRS (a non-participating jurisdiction).

Each participating jurisdiction will need to implement the CRS definitions in their law and publish specific guidelines for the financial institutions to follow.

5.2 Reporting/exchange

To the extent that an account holder is a reportable person, the financial institution needs to report the financial account information to the local tax authorities. The local tax authorities will subsequently submit the information to the authorities of the country where the account holder is a tax resident. The same applies with respect to the controlling persons of entities that have also been identified (see above). Before information can be exchanged with the participating jurisdictions, a number of stringent conditions will have to be complied with, with the view to protect the information exchanged.

A special look-through obligation has been introduced for certain investment entities established in non-participating countries and holding an account with a reporting financial institution (the financial institution will effectively also be required to identify the controlling persons from those entities).

5.3 Self-certification form

In order to apply the identification regulations in the correct manner, a financial institution is required, in virtually all cases, to request its account holders for its own self-certification for the purpose of establishing whether the account holder is a person with a reportable account. Most EU countries have already developed self-certification forms for the various categories of account holders, which can be used for CRS (and FATCA) identification.

A reporting financial institution has the statutory obligation to record what steps it has taken and on what evidential material it has relied upon in the implementation of the identification and reporting regulations.

6 Recommendations for the Practice

Swiss investment or asset managers and other entities should verify whether they qualify as financial institutions or not. The Swiss authorities will need to come up with further guidelines that will provide for more clarity in certain situations. If an entity qualifies as a financial institution, the entity is, in principle, obliged to identify its account holders by application of CRS (and FATCA) rules. The financial institution is required to lay down an internal identification procedure in a protocol. In addition, the financial institution is, in particular, required to register as a reporting financial institutions with the local tax authorities and to report certain accounts to the local tax authorities (in the case of Switzerland: the Swiss federal tax administration, ESTV).

If an entity is not a financial institution, the financial institutions with which the entity holds an account will submit a self-certification form. The entity itself does not have to take action until it receives such a form.

- 1) International standards on combating money laundering and the financing of terrorism & proliferation, 2012. These standards also raise many questions as to their application.

About the authors:

Ronald Wyss is Partner, Tax Partner at Loyens & Loeff Switzerland in Zurich. He is a member of the Tax Chapter Board of the Swiss-American Chamber of Commerce.

Dr. Beat Baumgartner is Tax Partner, Attorney at Law at Loyens & Loeff Switzerland in Zurich.