*euro*FINESCO *e*Book nº 3

# REQUIREMENTS OF THE COMMON REPORTING STANDARD

Dennis Swing Greene

PORTUGAL

**Ficha Técnica:**

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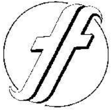



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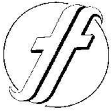




The Common Reporting Standard (CRS) is an information system for the automatic exchange of tax information, developed in the context of the OECD. So far, over 110 countries have signed up with more expected to join in the near future. Until now, the parties to most Double Tax Treaties in place for sharing information have done so only upon request. This approach has not always proven effective in preventing tax evasion. The new method is supposed to transfer all relevant information automatically and systematically.

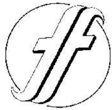
As of the date of publication, 110 countries have signed up to the Common Reporting Standard. Until now, the parties to most treaties which are in place for sharing information have done so upon request, which has not always proved effective in preventing tax evasion. The new system is supposed to transfer all the relevant information automatically and systematically. This agreement is informally referred to as GATCA (the global version of FATCA). However, CRS is not just an extension of FATCA. CRS has a much more ambitious scope.

## The CRS Handbook

What follows are abridged extracts from the CRS Handbook. This handbook was published with the express purpose of assisting government officials in the implementation of the Standard for the Automatic Exchange of Financial Account Information in Tax Matters (the "Standard"). It is a practical guide to the necessary steps to take in order to implement the Standard, drafted in plain language, with a view to making the content of the Standard accessible.

The Handbook provides an overview of the legislative, technical and operational issues and a more detailed discussion of the key definitions and procedures contained in the Standard. It is intended to be a proactive document and will be updated and enhance over time.

It is our opinion that by understanding the purposes and methods commonly implemented by tax authorities around the would, individuals will be better informed, more prepared and forearmed for the new “Brave New World” the awaits us all.





**Background: Creation of the Standard for Automatic Exchange**
For many years countries around the world have been engaging in the automatic exchange of information in order to tackle offshore tax evasion and other forms of non-compliance. The OECD has been active in facilitating automatic exchange by creating the legal framework, developing technical standards, providing guidance and training and seeking to improve automatic exchange at a practical level. Automatic exchange of information is widely practiced and is a very effective tool to counter tax evasion and to increase voluntary tax compliance.

In 2010, the US enacted the laws commonly known as FATCA (*Foreign Account Tax Compliance Act*), requiring withholding agents to withhold 30-percent of the gross amount of certain US connected payments made to foreign financial institutions unless such financial institutions agree to perform specified due diligence procedures to identify and report information about US persons that hold accounts with them to the US tax authorities. Many jurisdictions have opted to implement FATCA on an intergovernmental basis and, more specifically, to collect and exchange the information required to be reported under FATCA on the basis of a Model 1 FATCA Intergovernmental Agreement (herein "FATCA IGA"). Many of these jurisdictions have also shown interest in leveraging the investments made for implementing the FATCA IGA to establish automatic exchange relationships with other jurisdictions, which themselves are introducing similar rules.

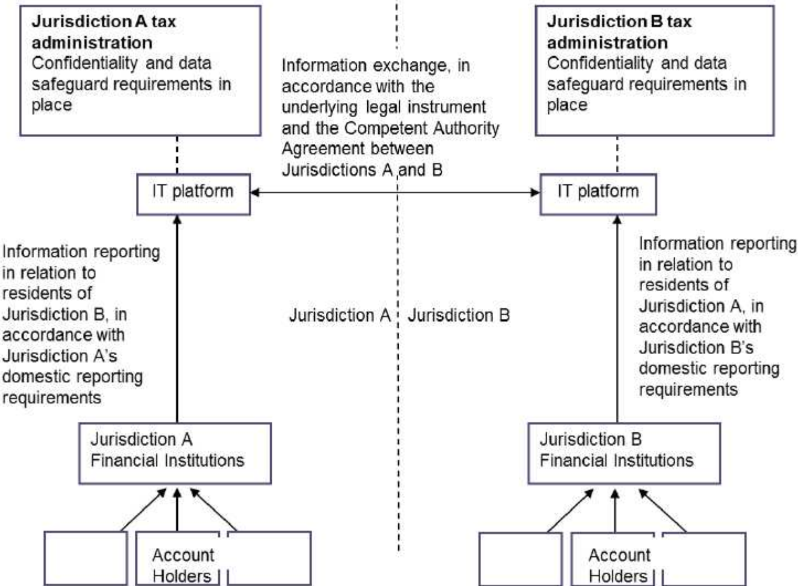
These countries recognise that, through the adoption of a common approach to automatic exchange of information, offshore tax evasion can be tackled most effectively while minimising costs for governments and financial institutions.

The OECD together with G20 countries and in close cooperation with the EU and other stakeholders has since developed the Standard for Automatic Exchange of Financial Account Information, or the Standard. This is a standardised automatic exchange model, which builds on the FATCA IGA to maximise efficiency and minimise costs.

**The automatic information exchange framework**

The diagram (Figure 1) depicts the automatic exchange framework for reciprocal information exchange under the Standard. In broad terms, financial institutions report information to the tax administration in the jurisdiction in which they are located. The information consists of details of financial assets they hold on behalf of taxpayers from jurisdictions with which their tax administration exchanges information. The tax administrations then exchange that information.

Figure 1: The reciprocal automatic exchange framework



This process requires:

- rules on the collection and reporting of information by financial institutions;
- IT and administrative capabilities in order to receive and exchange the information;
- a legal instrument providing for information exchange between the jurisdictions; and
- measures to ensure the highest standards of confidentiality and data safeguards.

**The Standard for Automatic Exchange**

The Standard consists of the following elements:

- The Common Reporting Standard ( "CRS") that contains the due diligence rules for financial institutions to follow to collect and then report the information, that underpin the automatic exchange of financial information;
- The Model Competent Authority Agreement ("CAA") that links the CRS to the legal basis for exchange, specifying the financial information to be exchanged;
- Commentaries that illustrate and interpret the CAA & the CRS;
- Guidance on technical solutions, including an XML schema to be used for exchanging the information and standards in relation to data safeguards and confidentiality, transmission and encryption.

In order to implement the Standard, a jurisdiction will need to take several steps to ensure financial institutions collect and report the necessary information and their tax administration has the capacity to properly receive that information from the financial institutions, hold it and exchange it.

**Overview of the Steps to Implement the Standard**

There are four core requirements to implement the Standard (as shown in Figure 2). They can be put in place sequentially, in any order, or in parallel. Each step is set out in further detail in this part of the Handbook. Cross references to the Standard, including its

Commentary, are included in the column on the right hand side of the page, with “CAA” referring to the Competent Authority Agreement, “CRS” referring to the Common Reporting Standard and “Com” referring to the Commentary. The page numbers refer to the pages in the consolidated Standard (that includes the Model Competent Authority Agreement and the Common Reporting Standard, and the Commentaries thereon – accessible online using the link in the footnote below).

The four core requirements to implement the Standard are:

Requirement nº1:
*Translating the reporting and due diligence rules into domestic law, including rules to ensure their effective implementation.*

Requirement nº 2:
*Selecting a legal basis for the automatic exchange of information.*

Requirement nº 3:
*Implementing IT administrative infrastructure and resources.*

Requirement nº 4:
*Protecting confidentiality and safeguarding data.*

## *Translating reporting and due diligence rules into domestic law*

The first core requirement for automatic exchange of information under the Standard is to require financial institutions to collect and report the specified information to the tax administration in the jurisdiction in which they are located. The tax administrations are then able to exchange that information with their automatic exchange partners.

The Standard provides a standardised set of detailed due diligence and reporting rules for financial institutions to apply to ensure consistency in the scope and quality of information exchanged. These due diligence and CRS reporting rules are the Common Report in Standard, or CRS. Essentially, the requirements specify:

- the financial institutions that need to report;
- the accounts they need to report on;
- the due diligence procedures to determine which accounts they need to report;
- the information to be reported.

**Key points when translating the CRS into domestic law**

The level of detail included and the drafting approach taken when developing the due diligence and reporting requirements contained in the CRS and the Commentary was designed to provide useful tool to assist in the translation of the requirements into domestic rules. Furthermore, this should help ensure consistency among jurisdictions implementing the Standard. As set out below, there are a number of issues which jurisdictions should consider early on in the implementation process. Consideration of many of these issues will likely be significantly assisted through consultations across government (such as with legal drafters and advisers – including data protection experts – and possibly with financial regulators) as well as with the businesses impacted and their representative bodies.

**The use of primary and secondary legislation and guidance**

To ensure financial institutions carry out the due diligence and reporting rules, new legislation and guidance will likely be required. Given that many of the jurisdictions implementing the Standard will also be implementing their FATCA IGA these processes can be aligned. This could mean implementing both the FATCA IGA and the Standard at the same time or supplementing the legislation and guidance put in place to implement the FATCA IGA to also incorporate the additional requirements in relation to the Standard.

Those jurisdictions that have already begun implementing the requirements for both the FATCA IGA and the CRS have tended to adopt an approach where as much of the detail as possible is contained in subsidiary legislation/regulations or guidance. This is to both ensure the implementation process is as efficient as possible and to ensure greater flexibility when making any subsequent amendments.

In broad terms the primary legislation could include the level collection and reporting requirements in the Standard, such as their scope, the application of enforcement provisions on financial institutions for non-compliance with the reporting obligations and provisions to enable the subsequent introduction of the more detailed reporting requirements. The more detailed requirements could then be included in secondary legislation/regulations, likely consisting of the more detailed aspects of the CRS. The remaining areas of the Commentary could then be included in official guidance (possibly even by means of a cross reference to the Standard).

When considering how to implement the Standard into domestic law and whether it is appropriate to include particular requirements in primary legislation, secondary legislation or regulations, or guidance, jurisdictions should specifically consider how to incorporate the areas of the Commentary that either provide optional due diligence procedures for financial institutions to follow or that contain additional substantive detail, rather than pure clarifications.

**Optional provisions**

There are areas where the Standard provides optional approaches for jurisdictions to adopt the one most suited to their circumstances. These optional provisions are set out below together with additional information on the options available under the EU Directive implementing the CRS as well as coordination with FATCA. Most of the optional approaches (in particular options 5 to 14) are intended to provide greater flexibility for financial institutions and therefore reduce their costs. Consequently, when implementing the Standard in domestic law, jurisdictions will most likely decide to allow for these optional approaches. Whether jurisdictions will make use of the other optional provisions will most likely depend on the specific domestic context in which the CRS is implemented.

## REPORTING REQUIREMENTS

a. **Alternative approach to calculating account balances**
   A jurisdiction that already requires Financial Institutions to report the average balance or value of the account may provide for the reporting of average balance or value instead of the reporting of the account balance or value as of the end of the calendar year or other reporting period. This option is likely only desirable to a jurisdiction that has provided for the reporting of average balance or value in its FATCA IGA. The EU Directive does not provide for the reporting of average balance or value.

b. **Use of other reporting periods**
   A jurisdiction that already requires Financial Institutions to report information based on a designated reporting period other than the calendar year may provide for the reporting based on such reporting period. This option is likely only desirable to a jurisdiction that includes (or will include) a reporting period other than a calendar year in its FATCA

implementing legislation. The period between the most recent contract anniversary date and the previous contract anniversary date (e.g. in the case of a Cash Value Insurance Contract), and a fiscal year other than the calendar year, would generally be considered appropriate reporting periods. The EU Directive allows a jurisdiction to designate a reporting period other than a calendar year.

c. **Phasing in the requirement to report gross proceeds**
A jurisdiction may provide for the reporting of gross proceeds to begin in a later year. If this option is provided a Reporting Financial Institution would report all the information required with respect to a Reportable Account. This will allow Reporting Financial Institutions additional time to implement systems and procedures to capture gross proceeds for the sale or redemption of Financial Assets. This option is contained in the Model FATCA IGAs, with reporting required beginning in 2016 and thus Financial Institutions may not need additional time for reporting of gross proceeds for the CRS. The EU Directive does not provide this option.

d. **Filing of nil returns**
A jurisdiction may require the filing of a nil return by a Reporting Financial Institution to indicate that it did not maintain any Reportable Accounts during the calendar year or other reporting period. The Model FATCA IGAs do not require nil returns but this could be required by local law.

**Due Diligence (Section II-VII of the CRS)**

e. **Allowing third party service providers to fulfil the obligations on behalf of the financial institutions**
A jurisdiction may allow Reporting Financial Institutions to use service providers to fulfil the Reporting Financial Institution's reporting and due diligence obligations. The Reporting Financial Institution remains responsible for fulfilling these requirements and the actions of the service provider are imputed to the Reporting Financial Institution. This option is available for FATCA. The EU Directive includes this option.

f. **Allowing the due diligence procedures for New Accounts to be used for Preexisting Accounts**
A jurisdiction may allow a Financial Institution to apply the due diligence procedures for New Accounts to Preexisting Accounts. This means, for example, a Financial Institution may elect to obtain a self-certification for all Preexisting accounts held by individuals consistent with the due diligence procedures for New Individual Accounts.
If a jurisdiction allows a Financial Institution to apply the due diligence procedures for New Accounts to Preexisting Accounts, a jurisdiction may allow a Reporting Financial Institution to make an election to apply such exclusion with respect to (1) all Preexisting Accounts; or (2) with respect to any clearly identified group of such accounts (such as by line of business or location where the account is maintained). This option may also be applied under FATCA and the EU Directive.

g. **Allowing the due diligence procedures for High Value Accounts to be used for Lower Value Accounts**
A jurisdiction may allow a Financial Institution to apply the due diligence procedures for High Value Accounts to Lower Value Accounts. A Financial Institution may wish to make such election because otherwise they must apply the due

diligence procedure for Lower Value Accounts and then at the end of a subsequent calendar year when the account balance of value exceeds $1 million, apply the due diligence procedures for High Value Accounts. This option may also be applied under FATCA and the EU Directive.

h. **Residence address test for Lower Value Accounts**
A jurisdiction may allow Financial Institutions to determine an Account Holder's residence based on the residence address provided by the account holder so long as the address is current and based on Documentary Evidence. The residence address test may apply to Preexisting Lower Value Accounts (less than $1 million) held by Individual Account Holders. This test is an alternative to the electronic indicia search for establishing residence and if the residence address test cannot be applied, because, for example, the only address on file is an "in care of" address, the Financial Institution must perform the electronic indicia search. The residence address test option is not available for FATCA. The EU Directive includes the residence address test.

I. **Optional Exclusion from Due Diligence for Preexisting Entity Accounts of less than $250,000**
A jurisdiction may allow Financial Institutions to exclude from its due diligence procedures pre-existing Entity Accounts with an aggregate account balance or value of $250,000 or less as of a specified date. If, at the end of a subsequent calendar year, the aggregate account balance or value exceeds $250,000, the Financial Institution must apply the due diligence procedures to identify whether the account is a Reportable Account. If this option is not adopted, a Financial Institution must apply the due diligence procedures to all Preexisting Entity Accounts. A similar exception exists for FATCA, however, FATCA allows the review to be delayed until the aggregate account balance or value exceeds $1 million.

j. **Alternative documentation procedure for certain employer sponsored group insurance contracts or annuity contracts**

With respect to a group cash value insurance contract or annuity contract that is issued to an employer and individual employees, a jurisdiction may allow a Reporting Financial Institution to treat such contract as a Financial Account that is not a Reportable Account until the date on which an amount is payable to an employee/certificate holder or beneficiary provided that certain conditions are met. These conditions are:

(1) the group cash value insurance contract or group annuity contract is issued to an employer and covers twenty-five or more employees/certificate holders;

(2) The employees/certificate holders are entitled to receive any contract value related to their interest and to name beneficiaries for the benefit payable upon the employee's death; and

(3) the aggregate amount payable to any employee or certificate holder or beneficiary does not exceed $1 million. This provision is provided because the Financial Institution does not have a direct relationship with the employee-certificate holder at inception of the contract and thus may not be able to obtain documentation regarding their residence. This option is not contained in the FATCA IGA but may be available through adopting the due diligence procedures of the US FATCA regulations. The EU Directive includes this option.

k. **Allowing financial institutions to make greater use of existing standardised industry coding systems for the due diligence process**

A jurisdiction may define documentary evidence to include any classification in the Reporting Financial Institution's records based on a standard industry coding system provided that certain conditions are met. With respect to a pre-existing

entity account, when a Financial Institution is applying its due diligence procedures and accordingly required to maintained a record of documentary evidence, this option would permit the Financial Institution to rely on the standard industry code contained in its records. This option is not contained in the FATCA IGAs, but similar requirements may be adopted for FATCA by using the definition of documentary evidence in the US FATCA regulations. This option is contained in the EU Directive.

l. **Currency translation**
All amounts in the Standard are stated in US dollars and the Standard provides for the use of equivalent amounts in other currencies as provided by domestic law. For example, a lower value account is an account with an aggregate account balance or value of less than $1 million. The Standard permits jurisdictions to include amounts that are equivalent (or approximately equivalent) in their currency to the US dollars amounts as part of their domestic legislation. Further, a jurisdiction may allow a Financial Institution to apply the US dollar amount or the equivalent amounts. This allows a multinational Financial Institution to apply the amounts in the same currency in all jurisdictions in which they operate. Both these options are available for FATCA. The EU Directive allows for this option.

m. **Expanded definition of Preexisting Account**
A jurisdiction may, by modifying the definition of Preexisting Account, allow a Financial Institution to treat certain new accounts held by preexisting customers as a Preexisting Account for due diligence purposes. A customer is treated as pre-existing if it holds a Financial Account with the Reporting Financial Institution or a Related Entity. Thus, if a preexisting customer opens a new account, the Financial Institution may rely on the due diligence procedures it (or its Related Entity) applied to the customer's Preexisting Account to determine whether the account is a Reportable Account.

A requirement for applying this rule is that the Reporting Financial Institution must be permitted to satisfy its AML/KYC procedures for such account by relying on the AML/KYC performed for the Preexisting Account and the opening of the account does not require new, additional, or amended customer information. This option is not contained in the FATCA IGAs, but similar requirements may be adopted for FATCA by using the definition of pre-existing account in the US FATCA regulations. The EU Directive includes this option.

n. **Expanded definition of Related Entity**
Related Entities are generally defined as one entity that controls another entity or two or more entities that are under common control. Control is defined to include direct or indirect ownership of more than 50 percent of the vote and value in an Entity. As provided in the Commentary, most funds will likely not qualify as a Related Entity of another fund, and thus will not be able to apply the rules described above for treating certain New Accounts as Preexisting Accounts or apply the account aggregation rules to Financial Accounts maintained by Related Entities. A jurisdiction may modify the definition of Related Entity so that a fund will qualify as a Related Entity of another fund by providing that control includes, with respect to Investment Entities described in subparagraph (A)(6)(b), two entities under common management, and such management fulfils the due diligence obligations of such Investment Entities. A similar approach can be achieved under FATCA by applying the Sponsoring Regime. The EU Directive also provides this modification.

o. **Grandfathering rule for bearer shares issued by Exempt Collective Investment Vehicle**
With respect to an Exempt Collective Investment Vehicle, a jurisdiction may provide a grandfathering rule if the

jurisdiction previously allowed collective investment vehicles to issue bearer shares. The Standard provides that a collective investment vehicle that has issued physical shares in bearer form will not fail to qualify as an Exempt Collective Investment Vehicle provided that:

(1) it has not issued and does not issue any physical shares in bearer form after the date provided by the jurisdiction;

(2) it retires all such shares upon surrender;

(3) it performs the due diligence procedures and reports with respect to shares when presented for redemption or payment;

(4) it has in place policies and procedures to ensure the shares are redeemed or immobilized as soon as possible and in any event prior to the date provided by the jurisdiction. FATCA contains this option and includes 31 December 2012 as the date after which bearer shares can no longer be issued and 1 January 2017 as the date to ensure redemption or immobilization. The EU Directive contains this option and includes 31 December 2015 as the date after which bearer shares can no longer be issued and 1 January 2018 as the date to ensure redemption or immobilization.

p. **Controlling Persons of a Trust**

With respect to trusts that are Passive NFEs, a jurisdiction may allow Reporting Financial Institutions to align the scope of the beneficiary(ies) of a trust treated as Controlling Person(s) of the trust with the scope of the beneficiary(ies) of a trust treated as Reportable Persons of a trust that is a Financial Institution. In such case the Reporting Financial Institutions would only need to report discretionary beneficiaries in the year they receive a distribution from the trust. Jurisdictions allowing their Financial Institutions to make use of this option must ensure that such Financial

Institutions have appropriate safeguards and procedures in place to identify whether a distribution is made by their trust Account Holders in a given year. The EU Directive does not contain this option.

### SUBSTANTIVE ADDITIONAL DETAIL

There are also areas of the Commentary that contain substantive additional detail that supplements the rules contained in the CRS. Depending on the local legislative framework, these may need to be included in legislation to be effective. This could include the following areas:

- Where the residence address test is allowed for the provisions relating to dormant accounts, the Documentary Evidence that can be relied on and the treatment of accounts opened at a time prior to AML/KYC requirements;
- The definition of Controlling Persons;
- The procedure when reporting information in relation to jointly held accounts;
- Ensuring that Financial Institutions can rely only on a self-certification from either the Account Holder or the Controlling Person to determine whether a Controlling Person of a Passive NFE is a Reportable Person;
- Applying the change of circumstances provisions to the residence address test (these provisions are explicitly provided for in the electronic records test, but the CRS does not apply them directly to the residence address test);
- The definition of the residence of a Financial Institution;
- The approach taken when a Financial Institution considers maintaining an account;
- The treatment of trusts that are non-financial entities (NFEs);
- Relying on the address of an Entity's principal office;
- Requiring the reporting of place and date of birth and the collection of taxpayer identification numbers (TINs).

It is also likely that financial institutions will need some jurisdiction specific guidance. While the Commentary should clarify most areas, consultation with the financial sector will highlight any remaining areas of uncertainty.

### WIDER TRANSITION WITH THE STAGGERED ADOPTION OF CRS

The CRS contains a so-called "look through" provision pursuant to which Reporting Financial Institutions must treat an Account Holder that is an Investment Entity that is not a Participating Jurisdiction Financial Institution as a Passive non-financial entity (NFE) and report the Controlling Persons of such Entity that are Reportable Persons. For purpose of this provision, a Participating Jurisdiction is a jurisdiction with which an agreement is in place pursuant to which there is an obligation to automatically exchange information on Reportable Accounts and is identified on a published list.

Almost 100 jurisdictions have now committed to implement the Standard to start exchanging information in 2017 or 2018 and it is expected that the time period between 01 January 2016 and 31 December 31 2017 will be a dynamic period for operationalising these commitments and putting in place exchange agreements.

This presents operational challenges to financial institutions, because they will need to manage entity account classifications jurisdiction by jurisdiction as well as changes in entity classifications and the associated on-boarding requirements as agreements come in place. These difficulties may not be balanced by significant compliance benefits on the assumption that committed jurisdictions will deliver on their commitments.

A jurisdiction could address this transitional implementation issue by treating all jurisdictions that have publicly and at government level committed to adopt the CRS by 2018 ("Committed Jurisdictions") as Participating Jurisdictions for a transition period. A possible further limitation would be to reserve this treatment to

Committed Jurisdictions that have signed the Multilateral Competent Authority Agreement or an equivalent exchange instrument. This effectively presumes commitments will be delivered upon and suspends the application of the look through provision for Investment Entities that are resident (or located) in Committed Jurisdictions. As a result, Reporting Financial Institutions would not be required to apply the due diligence procedure for determining the Controlling Persons of such Investment Entities or for determining whether such Controlling Persons are Reportable Persons. This of course should be revisited in the event commitments are not delivered on. A jurisdiction adopting this approach should make a statement that its list of Participating Jurisdictions will be re-assessed and updated no later than 1 July 2017, based on whether the listed Participating Jurisdictions have actually delivered on their commitment vis-à-vis the jurisdiction. A removal of a jurisdiction from the list of Participating Jurisdictions would then trigger an obligation on Reporting Financial Institutions to apply the due diligence procedures for determining whether the Controlling Persons of Investment Entities in such jurisdictions are Reportable Persons. To reduce burdens for Reporting Financial Institutions, a jurisdiction may also consider allowing their Reporting Financial Institutions to apply to such accounts the due diligence procedures for Preexisting Entity Accounts, even if such accounts were opened after 1 January 2016.

### JURISDICTION-SPECIFIC LOW RISK INSTITUTIONS AND ACCOUNTS

Given the standardised approach taken in the CRS, there will be Financial Institutions and Financial Accounts that present a low risk of being used for tax evasion but which the CRS does not specifically identify as such. The CRS therefore provides for jurisdictions to identify these as Non-Reporting Financial Institutions or Excluded Accounts (i.e. non-reportable accounts) in

their domestic law. This will be a key area for jurisdictions to consider during the legislative process.

A starting point for jurisdictions when considering what to identify as low risk are the institutions and accounts found in Annex II of the FATCA IGAs. However, jurisdictions must take into account that during the process of developing the Standard, it was decided that several of the categories in Annex II to the Model FATCA IGA were either not appropriate or not desirable in the context of the Standard and not to be included. These are categories such as Treaty Qualified Retirement Funds, Financial Institutions with a Local Client Base, Local Banks, Financial Institutions with Only Low-Value Accounts, Sponsored Investment Entities and Controlled Foreign Corporations, Sponsored and Closely Held Investment Vehicles. Consultation with the financial sector may highlight any additional institutions or accounts that might be considered for inclusion.

Jurisdictions will then need to consider whether the institutions and accounts that have been identified as potentially being low risk meet the terms of the Standard. The Standard requires that either the institution or account meets the conditions required by the categories of low risk institutions or accounts contained in the CRS, or they must be similar to the specified categories and have equivalent conditions to any particular requirements they do not meet. Finally, their inclusion as low risk must not frustrate the purposes of the Standard.

It is expected that each jurisdiction will have a single list of low risk financial institutions and a single list of low risk financial accounts (or excluded accounts) with respect to the Standard and that these lists will be published. The Global Forum will also assess the jurisdiction-specific lists to ensure the conditions of the Standard have been met.

## DIFFERENCES TO FATCA

An explicit objective when designing the Standard was to build on FATCA, and more specifically the FATCA IGA, as by maximising consistency with the FATCA IGA governments and financial institutions could leverage on the investments they are already making for FATCA. This was to ensure that a new international standard could be created, which would deliver the most effective tool to tackle cross-border tax evasion, while minimising costs for governments and financial institutions. While a large proportion of the Standard precisely mirrors the FATCA IGA, there are also areas of difference. These differences are due to:

- the removal of US specificities (such as the use of citizenship as an indicia of tax residence and the references to US domestic law found in the FATCA IGA);
- or where certain approaches are less suited to the multilateral context of the Standard, as opposed to the bilateral context of the FATCA IGA.

Many of these differences do not in fact require jurisdictions to take a different approach when implementing the two systems, further facilitated by the possibility in the Model 1 FATCA IGA for jurisdictions to allow financial institutions to apply the rules contained in the US FATCA Regulations as an alternative. This is because the Standard often incorporates definitions and processes contained in the current US FATCA Regulations. It would therefore be open to jurisdictions to adopt a single approach to these areas, both in relation to implementing the Standard and the FATCA IGA. Certain of these areas, as well as those where a unified approach is not possible, are highlighted in Part III of the Handbook. It should be noted that the comparisons reflect analysis by the OECD Secretariat to assist officials in their deliberations on implementation of the Standard alongside the Model 1 FATCA IGA. The interpretation and application of the FATCA IGAs remains a matter for the Parties to the Agreements.

## EFFECTIVE IMPLEMENTATION

Implementing the Standard effectively not only requires the reporting obligations to be translated into domestic law but the introduction of a framework to enforce compliance with those obligations. The Standard therefore specifically requires jurisdictions to ensure that the CRS is effectively implemented and applied by financial institutions, including the introduction of provisions that:

- prevent circumvention of the CRS (anti-abuse provisions);
- require reporting financial institutions to keep records of the steps undertaken to comply with the CRS (record-keeping requirements); and
- permit the effective enforcement of the obligations in the CRS (including penalties for non-compliance).

Jurisdictions will therefore need to assess the compliance framework they have and determine whether it meets the requirements of the Standard and that it is applicable in relation to a failure to meet the obligations of the domestic rules implementing the Standard. Where there are gaps, new provisions will need to be introduced. Another example is regional legislation such as the European Directives on the automatic exchange of information.

**The legal instrument**

Once the financial institutions have collected and reported the information to their tax administration, it is exchanged with the jurisdiction's automatic exchange partners. There are various routes to do this but all require a legal instrument to be in place. This is because the legal instrument provides the necessary protections in relation to data safeguards and confidentiality to ensure the information is treated appropriately, for example, that it is only used for the purpose for which it is exchanged. Legal instruments that permit automatic exchange under the Standard include:

- Double Tax Agreements containing the standard OECD Model Article26.
- The Multilateral Convention on Mutual Administrative Assistance in Tax Matters (the "Convention"), Article 6 of which specifically provides for the optional use of automatic exchange.
- Tax Information Exchange Agreements ("TIEAs") that provide for the automatic exchange of information. (It should be noted that automatic exchange goes beyond the OECD standard model TIEA, so would need to be specifically included to allow for the TIEA to be used for exchange under the Standard, which may be achieved by inserting the language of Article 5A of the OECD Model Protocol).

Given the large number of signatories to the Convention, joining the Convention is probably the most efficient route to ensure information can be automatically exchanged with many jurisdictions under the Standard.

## The Model Competent Authority Agreement

In addition to the legal instrument for exchange, at the administrative level automatic exchanges are typically based on separate agreements between Competent Authorities that set out the details of the information to be exchanged, how and when. The Standard therefore contains a Model CAA.

There are three Model CAAs contained in the Standard, each developed to suit a different scenario:

- The first Model CAA is a bilateral and reciprocal model. It is designed to be used in conjunction with Article 26 of the OECD Model Double Tax Agreement.
- The second Model CAA is a multilateral CAA that could be used to reduce the costs of signing multiple bilateral agreements (although the actual information exchange would still be on a bilateral basis). This could be used in conjunction with the Convention, something a very significant number of jurisdictions have already done (see below).
- Finally the third Model CAA is a non-reciprocal model provided for use where appropriate (e.g., where a jurisdiction does not have an income tax).

All of the Model CAAs specify the following information:

- the underlying legal instrument under which the information will be exchanged;
- the precise information to be exchanged and the time and manner of that exchange;
- the format and transmission methods, and provisions on confidentiality and data safeguards;
- details on collaboration on compliance and enforcement;
- details of entry into force, amendments to, suspension and cancellation of the CAA.

Jurisdictions are free to specify other provisions in the CAA as agreed by the signatories to it. There are specific areas where the CAA provides for particular optional provisions to be included, again where jurisdictions agree. These are:

- allowing for direct contact between the exchange partner jurisdiction's tax administration and their partner's domestic financial institutions in relation to minor errors or non-compliance;
- phasing in the exchange of information in relation to gross proceeds; and
- providing for the alternative method of calculating account balance or value.

Jurisdictions will also need to consider whether their domestic laws require particular data protection and confidentiality requirements to be included, in addition to the requirements in the Model CAA.

As provided for in the Model CAAs, the Standard does not require jurisdictions to either conclude the CAA before bringing forward legislation to implement the due diligence and reporting rules, nor do the rules need to be put in place before the signing of the CAA.

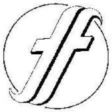
**The Multilateral Competent Authority Agreement**

In October 2014, 51 jurisdictions concluded a multilateral Competent Authority Agreement (the MCAA) to implement the Standard. This agreement now has 61 signatories and is open for others to sign.

The MCAA has been concluded under Article 6 of the Convention and therefore provides the most efficient route to widespread exchange.

The MCAA is a framework agreement and does not become operational until domestic legislation is in place and the requirements on data protection/confidentiality are met. It can be signed with any intended exchange dates, which are specified at the time of signing.

Exchange starts between two signatories once they both provide notification stating they wish to exchange with each other.

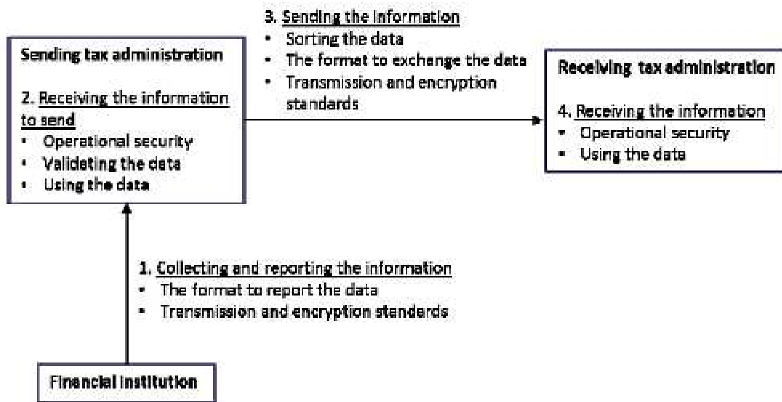




***Putting in place IT & Administrative Infrastructure & Resources***

The legal framework for the collection and exchange of information is only part of the framework when it comes to implementing the Standard. Tax administrations also require technical and administrative capacity to properly manage the information (whether sending or receiving data). It is important to consider these requirements early in the implementation process to ensure adequate resources are put in place by the time of exchange. Figure 3 depicts the key areas of the automatic exchange framework that rely on administrative and IT capacity.

**Figure 3: IT and administrative infrastructure: areas to consider**




IT and administrative infrastructure: areas to consider both for financial institutions to prepare the data to report and for the tax authority to validate and sort the information before exchanging it. Consideration should also be given to the interaction between the reporting date in relation to the Standard and the other tax reporting requirements, whether domestic or international.

## Collecting and reporting the information

The first element to the IT and administrative infrastructure is the reporting that takes place by financial institutions to the tax administration. It is important to engage with financial institutions early as they will often need to have new projects approved to build the systems to report the information.

Consideration will need to be given to the deadlines for financial institutions to report the information. It will need to be after the end of the calendar year and before the end of September the following year, which is the deadline contained in the Model CAA for Competent Authorities to exchange the information. Jurisdictions will need to build in time in that 9 month window.

Jurisdictions will also need to decide the format in which they require financial institutions to report the information. While the Standard does not prescribe an approach, jurisdictions may wish to use the same format in which the Standard requires the information to be exchanged (the CRS Schema) so as to remove the need for the tax administration to reformat the data for exchange (which must take place in accordance with the CRS Schema). It is likely that consultation with financial institutions will be required to establish the format. In considering the format to use consideration may be given to ensuring as much consistency as possible to other reporting requirements (whether domestic or in relation to non-residents) to ensure maximum efficiency. For example, the CRS Schema is virtually identical to the FATCA schema in terms of structure and content, with both schemas making use of XML (extensible mark-up language). So for tax authorities and financial institutions that will be reporting and exchanging information under FATCA, the use of the CRS Schema will likely not require significant additional investment.

There will also need to be a filing process for financial institutions to report the information, such as through a government portal. This will require secure transmission channels and protocols, through encryption or physical measures or a combination of both. The Standard provides minimum standards in this area. The transmission and encryption methods will therefore need to meet appropriate minimum standards in relation to the confidentiality and integrity of the data to ensure the information is not disclosed to unauthorised persons and that the data has not been altered in an unauthorised manner.

It should be noted that the Standard may well require reporting to the tax authority by financial institutions that may not currently be required to report tax information (for example the fund industry, trust and service providers and insurance companies). An assessment should be made early on of the financial institutions that will be impacted and the jurisdiction should then actively reach out to them, through their representative bodies for example, in order to discuss what the requirements are and how best to implement them. The institutions may include very small institutions, a very low number of a particular type of institution or institutions with very few accounts. In these cases simplified arrangements could be appropriate. In certain cases this could, for example, include an interface where the information is inputted manually.

**Receiving the information to send**

In advance of the tax authority receiving the information from the financial institutions they will need to ensure they have the appropriate operational security to hold the data. This means having good managerial, organisational and operational procedures, as well as technical measures including hardware and software tools. Ideally security should be managed in a manner that is consistent with best practice standards, such as the latest ISO 27000 series Information Security standards.

Some level of validation of the data will also likely need to be undertaken to check the format of the data (i.e. that it has been entered correctly, with the mandatory information included) and that it will have relevance to the receiving jurisdiction, a common data protection requirement (i.e. the correct data package is being sent to the correct jurisdiction). This validation would also likely be part of the process to ensure financial institutions have effectively implemented the Standard.

Depending on the jurisdiction's tax system and other data they have on file, the information on non-residents received from financial institutions for forward transmission could also potentially be used for compliance purposes.

Information in relation to undocumented accounts should also be identified and investigated, including whether it results from a failure to comply with AML/KYC requirements.

**Sending the information**

Before being sent, the data will then need to be processed for onward transmission. This will involve compiling all the reports received from the financial institutions and then sorting them by automatic exchange partner, ready for onward transmission.

The information then needs to be sent to the partner jurisdictions with which the implementing jurisdiction has an automatic exchange relationship, by the end of September following the end of the calendar year to which the data relates.

To ensure consistency and predictability the Standard prescribes a standardised transmission format for jurisdictions to use when sending the information (the CRS Schema). It is almost identical to the schema used for exchanging information under FATCA.

In recognition that jurisdictions are already successfully automatically exchanging information, the Standard provides minimum standards in

relation to transmission and encryption, rather than mandating a single solution. Jurisdictions will therefore need to agree on effective transmission methods and encryption standards for the secure exchange of information between each other. There is sufficient time for jurisdictions to agree on one or more methods with the very first exchanges under the Standard not taking place until well into 2017. It should be noted that the MCAA, signed between a large number of jurisdictions, includes a commitment to work towards and agree on one or more methods for data transmission including encryption standards with a view to maximising standardisation and minimising complexities and costs.

Where jurisdictions do not use a common alphabet they will also need to consider issues in relation to transliteration and whether to agree in advance on a certain approach with their exchange partners. Where there is no agreement in advance, as a default, the sending jurisdiction should if requested transliterate the information into a Latin alphabet.

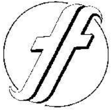
**Receiving the information**

Similarly to when the tax administration receives information from financial institutions, the tax administration that receives the data from its information exchange partners will also need to ensure it has appropriate operational security measures in place. For example, the information exchanged must be kept confidential in accordance with the exchange agreement, including limitations on use of the information only for tax purposes.

While not required by the Standard itself, when putting in place the necessary IT and administrative processes that are required to comply with the Standard, jurisdictions may want to consider how to best make use of the standardised bulk data which will be received. It is often the case that maximization of the potential

compliance benefits of the data requires consideration early in the process of building the systems and processes to receive, hold and exchange the information.

Considerations could include automated processes such as data matching and interventions and analysis to highlight new or emerging areas of risk. Furthermore, mechanisms to provide management information and feedback could be useful tools to evaluate the benefits of receiving the data and the effectiveness of particular interventions, as well as to provide feedback to the sending jurisdiction on the quality of the information received.





## *Protect confidentiality and safeguard data*

The confidentiality of taxpayer information is a fundamental cornerstone to tax information exchange and is relevant to all of the previous three requirements (domestic legislation, information exchange instruments and operational matters). Taxpayers and tax administrations have a legal right to expect that sensitive financial information remains confidential and the Standard therefore contains extensive guidance on confidentiality and safeguarding data.

Confidentiality and safeguarding data is a matter of both the legal framework and systems and procedures to ensure the legal framework is respected in practice. Jurisdictions that have had to consider these issues in relation to implementing their FATCA IGA will be well placed when it comes to ensuring equivalent arrangements apply with respect to data collected and exchanged under the Standard.

The legal framework includes both domestic law and the international exchange instrument. Together these will need to limit the use of the data to the purposes specified in the exchange instrument and include penalties for improper disclosure.

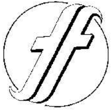
The systems and procedures should include appropriate policies in relation to employees such as background checks and training, restricting access to sensitive documents, systems to protect the data such as identifying those with access and having audit trails to monitor access, restrictions on transmitting the data and appropriate information disposal policies. Regular risk assessments should also be completed and confidentiality policies updated as necessary. Policing of unauthorised access and disclosure should also be carried out, with appropriate penalties imposed.

Before sending the information jurisdictions will also need to ensure their information exchange partners have the required standards in relation to ensuring the confidentiality of the data. In order to assist in this process the Standard includes a questionnaire that may be used to assess another jurisdiction's confidentiality safeguards. The questionnaire has been designed to also be consistent with the approach taken by the US under the FATCA IGA.

**Breaches of confidentiality**

The CAA includes a provision that requires a Competent Authority to notify immediately the other Competent Authority of a breach or failure of the confidentiality requirements. Furthermore, it is explicitly stated that noncompliance with the confidentiality and data safeguard provisions would be a justification for the immediate suspension of the CAA.

The Standard also outlines the required domestic framework in relation to breaches of confidentiality, including penalties or sanctions for improper disclosure and investigatory procedures to be triggered if a breach takes place.



# Conclusion

More than 100 countries have formally agreed to participate in CRS, including places with less-than-stellar reputations for fiscal transparency (e.g., Panama). But the U.S. has declined to jump on the CRS bandwagon. There are two reasons for this.

First, the IRS is statutorily barred from engaging in the type of mutual information sharing envisioned by CRS. Second and more importantly, the U.S. does not need CRS to obtain critical information about U.S. taxpayers who maintain foreign bank accounts. The US already receives that information through FATCA.

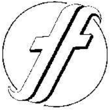
It is important to note the principal difference between the two systems. The premise of CRS is reciprocity. The information flow is a two-way. By contrast, FATCA represents a one-way street in which the IRS is the recipient, not the provider, of tax information. Other countries begrudgingly comply with FATCA because the alternative would expose their financial institutions to unacceptably harsh withholding obligations. FATCA has few friends in the international community. Other governments complain that it smacks of fiscal imperialism. The global banking sector hates it because it forces them to incur heavy compliance costs. Privacy advocates oppose it because they see virtue in citizens being able to shelter assets from the government's prying eyes.

Despite these flaws, FATCA is helping to narrow the U.S. tax gap. Approximately 20 percent of the revenue gains from automatic information exchange have accrued to the U.S. government. Would the US stand to gain more by repealing FATCA and adopting CRS? If not, what exactly is the case for altering the status quo from the US perspective?

The argument seems to be that the US would be a kinder, gentler player on the international stage were they to assist other countries in addressing their tax gaps. That may be true, but consideration should be given to the chilling effect CRS might have on domestic capital formation. If you can imagine a world in which the U.S. adheres to FATCA while every other country participates in CRS (which is where things are currently headed) there's an incentive for foreign capital to flock to U.S. banks. The US would enjoy a competitive advantage to the extent that they are less transparent. Replace FATCA with CRS and that incentive goes away, although global transparency is presumably enhanced.

The question for policymakers is how to strike an appropriate balance between promoting fiscal transparency and protecting US national economic interests. These priorities are not in conflict, but the tension between adopting CRS and sticking with FATCA may challenge that belief.

The dichotomy of the two systems may prove to be their downfall. Universal participation is never easy. It becomes even more challenging when the two different systems try to coexist with opposing purposes: one supporting reciprocity; the other "me first".



# *Notes*

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