Issue
01
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Regular journal of exploiting Common Reporting Standard weaknesses

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this issue

Exploiting Active NFE P.1

Misunderstand reporting of Entity Account Holder P.2

Trust-based sham retirement schemes crushed by FAQ P.3

This issue highlights

Converting Passive NFE to Active NFE

Incorrect reporting on Active NFE

Hong Kong ORSOs and Gibraltar QNUPS blown out of the water

Mandatory Disclosure Rules and Addressing abuse of residence by Investment

The OECD has always said the CRS is a living document, subject to refinement and improvement as inefficiencies are discovered to be used.

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The unintended exploitation of exempting owners of untaxed Active NFEs from being reported

Tax evaders gleefully capitalize on offshore Active NFEs not subject to automatic exchange of information with respect to its controlling persons.

Unjustified exemption: The OECD did not want to overwhelm exchange of information with respect to legitimate businesses. However, there is no excuse for exempting business owners that establish offshore companies to transact through. Tax evasion by portfolio holders is just as criminal as undeclared commissions, consulting, entertainer salaries, royalties, trading profits, property churning and intellectual property. The EU Commission expanded the EU savings tax to include any entity not subject to effective taxation.

Embed investments: Greek shippers embed and remit billions of investment income in their Marshall Island offshore companies. Why should the amount of passive income not be reported?

Collusion with Financial Institutions: Many banks assist their clients be Active NFE simply because the company does active business or trade. This looks at income test but not asset test.

Fake Intangible assets: IFRS internally generated IP expense, not an asset since cannot distinguish expenses that developed IP from operational expenses**.** Acquired IP must be amortized – cannot grow unless show there is an active market.

Holding company: Account holder sets up a parent company to strip the underlying passive NFE of all its cash on a regular interim dividend basis. The subsidiary will then be an Active NFE if it earns non-passive income, and the parent company qualifies as an Active NFE even if it just holds cash and earns 100% dividends. Crazy.

More Holding company craziness: (1) Parent trust company can be an Active NFE despite a holding company having a completely different purpose (2) Parent company is an Active NFE if it holds subsidiaries that do business or trade even if the subsidiaries are not Active NFEs.

Logical conclusion: Untaxed entity should **not** qualify as an Active NFE.

Growl I of this issue

Non-interest bearing deposits

Many firebrand lawyers sow confusion and misinformation by wrongly opining that cash may not necessarily be a financial asset

This, in the face of FATCA stating that cash is indeed a financial asset, and despite the OECD CRS FAQ stating unambiguously that cash is an asset that can produce “or has the potential to produce” passive income. So even a negative bearing deposit is a financial asset. Also, anyone remotely conscious should figure that cash is much of a financial asset as a bond.

As only financial assets are reported, it is inconceivable that the OECD would permit no reporting on the amount of cash of an account holder.

What compliance always gets wrong about reporting on an Active NFE

Ask 100 banks where they report the Active NFE account holder to, and you will assuredly receive 100 incorrect replies

The author, while presenting seminars in dozens of CRS jurisdiction to hundreds of Financial Institutions concludes unequivocally not a single CRS officer follows the tax residency guidance of the CRS Commentary. At the risk of being called lazy, and without interpretation, I hereby replicate the relevant clauses of CRS 144 - 145

The following examples illustrate how an Entity's residence for tax purposes may be determined:

Example 1: *A company is incorporated in Jurisdiction A and has its place of effective management in Jurisdiction B. Under the laws of Jurisdiction A, residence for tax purposes is determined by reference to place of incorporation. The same applies under the laws of Jurisdiction B. Thus, the company is resident only in Jurisdiction A.*

Example 2*: Same facts as Example 1, except that, under the laws of Jurisdiction B, residence for tax purposes is determined by reference to place of effective management. Thus, the company is resident in both Jurisdictions A and B.*

Example 3: *Same facts as Example 1, except that, under the laws of Jurisdictions A and B, residence for tax purposes is determined by reference to place of effective management. Thus, the company is resident only in Jurisdiction B.*

“Surprise, surprise. An untaxed entity may not have a tax residence and hence no reporting on entity account holder is possible”

Example 4: *Same facts as Example 1, except that, under the laws of Jurisdiction A, residence for tax purposes is determined by reference to place of effective management and, under the laws of Jurisdiction B, residence for tax purposes is determined by reference to place of incorporation. Thus, the company is not resident in either Jurisdiction A or B.*

Reporting Financial Institutions are not expected to carry out an independent legal analysis of relevant tax laws to confirm the reasonableness of a self-certification.

However, the OECD has facilitated easy checkup of determining tax residency of place of incorporation and place of management with its tax residency web page

http://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/tax-residency/

Sham Retirement Plans

In May 2017 the OECD complained to Hong Kong about the abuse of trustee-based pensions (ORSOs) marketed to circumvent the CRS. Hong Kong Pension Authority, without investigating, effectively retorted “no CRS evasion happening here, so move on” A year later the OECD has subsequently crushed these sham retirement schemes with a FAQ update

Non-Reporting Financial Institution: *Compartmentalization of Broad Participation Retirement Funds*

CRS Section VIII(b)(5)(a) requires for a Financial Institution to qualify as a Non-Reporting Financial Institution under the Broad Participation Retirement Fund category, the Financial Institution needs, inter alia, to ensure that it has no single beneficiary with a right to more than 5% of the fund’s assets.

In case the fund is compartmentalized into sub-funds that are in practice working as separated pension products, including through the segregation of the assets, risks and income attributed to such sub-funds, does the 5% test apply at the level of the fund or at the level of each sub-fund?

In such cases, the test of whether a single beneficiary has a right to more than 5% of the fund’s assets is to be applied at the level of each sub-fund.

“This FAQ update simultaneously kills the trend of trustees and insurers to provide segregated retirement / disability plans which avoided the CRS”

TIP on Tax Residence

Q: Reasonableness or how must I know?

Issue 02 will delve into how Financial Institutions must crack the misrepresentation by account holders who fallaciously self-certify that the black listed jurisdiction is their one and only tax residence, obtained via a residence by investment scheme. The rule that Financial Institutions cannot rely on a self-certification or Documentary Evidence if they know, or have reason to know, that such self-certification or Documentary Evidence is unreliable, incorrect or incomplete. It is fascinating that many banks blindly accept that their multi-millionaire client is resident in a rented apartment for USD 10,000 p.a. yet children are educated back home.

This topic is tackled in detail in issue02. The Financial Institution will determine true tax residencies using indicia obtained from permanent homes, centre of vital interest and habitual residence criteria.

Growl II of this issue

Industry trend that Handbook and FAQ are not the law

A surprising number of lawyers opine the CRS Implementation Handbook, nor the CRS FAQs have the force of law. It is only the CRS legislation of the country that is mandatory. However, let us leave it up to the OECD to clarify

” The ***Handbook*** *provides a guide on the necessary steps to take to implement the Standard. 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. This second edition of the* ***Handbook*** *is intended to be a living document and will be further updated and completed over time.*

The objective of the ***Handbook*** *is to assist stakeholders in the understanding and implementation of the Standard and should not be seen as supplementing or expanding on the Standard itself.*

The OECD maintains and regularly updates this list of ***Frequently Asked Questions*** *on the application of the CRS. These* ***FAQs*** *were received from business and government delegates. The answers to such questions provide further precisions on the CRS and help to ensure consistency in implementation.”*

Upcoming publications

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next issue 02

Switched account to USA – Proposed CTIFA will identify beneficial owner **P.1**

How OECD will tackle UAE, the most abused residence by investment jurisdiction scheme in the world **P.2**

Irrevocable Singapore trusts reporting zero for settlor **P.3**

Irrevocable insurance killed off but pre-existing insurance? **P.4**

following issue 03

Single owned investment entity loophole **P.1**

Difference between location of FI vs. entity account holder **P.2**

Listed vs. regularly traded **P.2**

Beneficiaries and founders of foreign protector US trusts will soon be accesible by foreign authorities through the proposed USA national directory **P.3**

a sprinkling of topics in future issues…

EU greylisted 65 countries for not joining CRS – who will never join

FATCA reciprocal reporting mostly does not exist despite IGA 1A

CRS jurisdiction advisor managing account held in USA

Can an entity with intangible assets qualify as an Active NFE

Why a trust is different from a holding company

When is disability insurance in scope

Compartmentalized retirement / disability plans dead – now what

Funds shifting units to non-participating custodians

Why worry about Mandatory Disclosure Rules if it is not a minimum standard

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