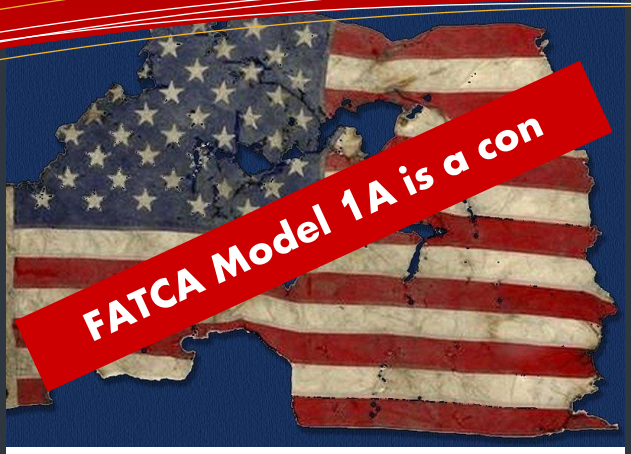
Issue
04

Regular journal of exploiting Common Reporting Standard weaknesses

CRS TIMES

21 July 2018

Author: Mark Morris www.the-best-of-both-worlds.com



this issue

Issue highlights

The FATCA model 1A reciprocal exchange of information does not mention that the USA will not provide the promised information on a reciprocal basis if Congress does not deem the receiving country as being appropriate to receive information.

What will happen to wealth managers who simply told clients to move accounts to USA, but wealth manager maintains the portfolio management mandate.

Why practioners are ignorant if they advocate placing intangible assets in a Passive Entity so that it passes the asset test to qualify as an Active NFE and hence no reporting on Controlling Persons.

Which jurisdictions cannot or will not join CRS due to insurmountable political issues.

OECD is satisfied that USA has entered 1A Intergovernmental Agreements for some insignificant reciprocal reporting as well as a political commitment to achieve equivalent levels of reciprocal exchange of information.

Facts on the ground are indicative the OECD is being conned

The United States has undertaken automatic information exchanges pursuant to FATCA from 2015 and entered into Intergovernmental Agreements (IGAs) with other jurisdictions to do so. The Model 1A IGAs entered into acknowledge the need for the USA to achieve equivalent levels of reciprocal automatic information exchange with partner jurisdictions, including a political commitment to pursue the adoption of regulations and to advocate and support relevant legislation to achieve such equivalent levels of reciprocal automatic exchange.

There is no chance Congress will approve automatic exchange of information. The reciprocal IGA information is restricted to depositary interest held by individuals, with no reporting on capital value. Furthermore, US banks offer CRS evaders zero interest deposits or products that simulate interest, as was done to avoid the EU Savings tax directive more than ten years ago.

Unacknowledged by the OECD, is that Congress maintains a political biased list of countries that the US regards as appropriate provide information to. This is updated annually with one or two additions. **See Rev Proc 2017-46 which has only around 40 countries, compared to the 100+ IGA Model 1A.**

"After how many more years of no progress on the political commitment will appeasement by the OECD no longer be acceptable?"

CRSTimes
CRS Expert

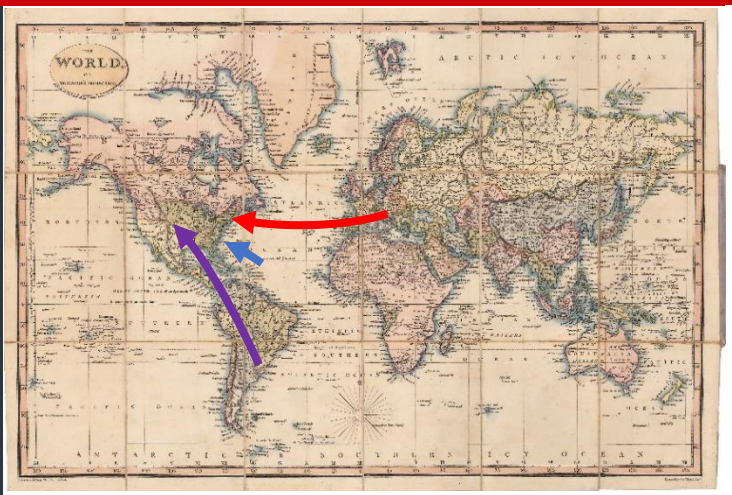
Growl of this issue

Some Trustees / Councils are incorrectly self-interpreting that they do not have to report on settlors / founders of investment entity irrevocable trusts/ foundations if the settlor / founder is not a beneficiary.

There is no justification or logical reason that the OECD states the entire account value must be reported for settlors of Passive NFE irrevocable trusts, but that trustees or jurisdictions interpret that a zero value may be reported for the same trust if it is an investment entity.

The longer the OECD acquiesces on Singapore and Liechtenstein allowing a zero value to be reported for investment entity irrevocable trusts, the longer this loophole will be exploited.

CRSTimes
CRS Expert



CRS-territory based wealth manager managing assets held in USA

CRS Effective Implementation Anti Avoidance

Shift Maintenance of an Account to USA

CRS Commentary page 208 par (5) - A Reporting Financial Institution advises a customer to maintain an account with a "Related" Entity in a non-Participating Jurisdiction that enables the Reporting Financial Institution to avoid reporting while offering to provide services and retain customer relations as if the account was maintained by the Reporting Financial Institution itself. In such a case, the Reporting Financial Institution should be considered to maintain the account and have the resulting reporting and due diligence requirements.

As the above clause naively restricted anti-avoidance to a related entity, FIs merely advised clients to switch account to an unrelated entity. Easier still, the account can be moved to an associated FI which is not necessarily a related entity because the CRS defines Related Entities as generally where 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% of the vote and value in an Entity.

The OECD to tackle this simple, loophole simply needs to remove the word "Related" from the anti-avoidance clause.

Do CRS jurisdiction wealth managers commonly manage financial assets located in the USA?

Answer: Yes, many banks have set up subsidiaries in some territories where they did not obtain a banking license but was easy to obtain an investment advisory license. Other banks have closed their subsidiaries or branches in tax havens.

These banks often advised unregulated clients to simply move their accounts to the USA. However, the bank continues to manage the portfolios of these client whose accounts are now with well know US custodians. The asset managers brazenly place on their website that the assets are custodied with strong FIs such as Pershing, USA.

Can intangible assets help an entity's be categorized as an Active NFE?

Stuffing a balance sheet with self-generated or synthetically acquired Intellectual Property will generally not help an entity to become an Active NFE if one follows the International Financial reporting Standard (IFRS) treatment of intangible assets as a asset.

Many ill-informed practioners erroneously advise that their client generate or procure (set up offshore and then buy it) an intangible asset such as Intellectual Property with regard to say their brand / logo. As long as income is mostly passive, the generated IP asset will ensure the entity is an Active NFE if it accounts for most of the balance sheet asset value.

Unbeknownst to them, the International Financial Reporting Standards (IFRS) – IAS 38 on internally generated intangible assets such as Intellectual Property says costs to generate such type of intangible asset cannot be an asset and must be expensed in the year of incursion as it is impossible to distinguish these costs from operational costs.

The only costs that may be amortised is developmental costs such as laboratory.

Acquired intangible assets can be amortised in balance sheet and amortised over a realistic short term. The intangible asset cannot appreciate unless it can be shown there is an active market and demonstrable price for the intangible asset.

OECD on intangible assets

Intangible assets are assets that do not have a physical or financial embodiment. Termed 'intellectual assets' in previous OECD work, intangible assets have also been referred to as knowledge assets or intellectual capital. Much of the focus on intangibles has been on R&D, key personnel and software.

BEPS Action 8 Implementation Guidance on Hard--to-Value Intangibles deals with transfer pricing and payments for intangibles from one entity to a low taxed entity.

However, the exploitation of intangible assets for CRS mostly concerns valuing fake intangibles for the asset test of an Active NFE, assuming the entity genuinely earns mostly non-financial income.

Which jurisdictions will not be invited to join CRS by OECD, nor implement automatic exchange of information for a long time, if ever?

Several polities that have limited diplomatic recognition as a dejure sovereign state, and are referred to as "disputed states" will not be joining CRS in the foreseeable future.

These states that are neither UN members nor UN observers such as Palestine, Republic of Kosovo, Republic of South Ossetia, Republic of Abkhazia. Two states recognized by only non-UN Member states are Transnistria and Artsakh (formerly known as the Nagorno-Karabakh Republic)

Taiwan (ROC) is not recognized by China but it has numerous double tax treaties and has committed to join CRS by 2020 but Is not on the OECD invited list. However, it is grey listed by EU as an uncooperative tax haven for not joining CRS.

Upcoming publications

next issue 05

When is a holding company NOT an Active NFE if it holds subsidiaries doing business or trade

Loophole analysis - is a trust different from a holding company?

Why look through non-reportable FIs that own passive NFE P.3

passive NFE

What is the asset test for an Active NFE

a sprinkling of topics in future issues…

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

When will disability insurance not qualify as a broad participation retirement fund

EU and OECD attack on USA non-participation

What is 80% activities of holding Active NFE test?

To subscribe:

mark.morris@the-best-of-both-worlds.com

+41 76 212 20.24

CRSTimes
CRS Expert