

Author: Mark Morris

www.the-best-of-both-worlds.com

## Issue highlights

What is categorization of an ICO?

Is Microfinance business an Active NFE if it earns mostly interest?

If an investment entity holds subsidiaries that engage in business or trades, can it be an Active NFE?

Is it always possible to look-through FIs holding Passive NFEs? What about non-participating FIs such as Custodians?

Must trustee report on protectors of investment entity trusts if FAQ is not obligatory? Must bank report on protectors of NFE trusts if no control?

What is reported or not reported if jurisdiction aligns beneficiaries of NFE trusts with investment entity trusts?

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Which countries will likely never join AEOI

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Determining tax residency of entities and controlling persons?

Why do the FIs wrongly equate listed on large stock market as regularly traded?



## INITIAL COIN OFFERINGS Is sale of tokens considered financial income. Will cash from sales make it a Passive NFE? No!

The OECD in its Mandatory disclosure Rules confirms it is an avoidance arrangement to move assets into financial like assets such as cryptocurrency. Hence, it is certain that crypto currency is not financial assets. As the assets an ICO holds is predominantly tokens, the assets of an ICO entity is predominantly not financial assets.

Regarding income, the sale of tokens is obviously sale on non-financial assets. Hence the income is not passive income.

Therefore, an ICO is an Active NFE type[A] based on its assets and income.

## this issue

FAQ on CRS, Initial Coin Offerings, Microfinance, Which holding company not an Active NFE, Looking through FIs owning Passive NFEs, Protectors of investment entity, Equating beneficiaries of passive NFE trusts, Discretionary management on one dollar, Kosovo and Palestine, Why Puerto Rico Habitual residence, Listed not mean regularly traded.

## If an investment entity holds subsidiaries that engage in business or trades, can it be an Active NFE?

No. This is the most misapplied CRS clause. Once an entity is classified as an investment entity, it cannot be recategorized an Active NFE if it holds subsidiaries that engage in business or trades. Note that the definition of Active NFE is an NFE that meets any of the 8 criteria. Just because an investment entity meets the same criteria does not mean the investment entity becomes an Active NFE.

The CRS moot clause is an Active NFE cannot be an investment entity does not mean an investment entity can become an Active NFE.

# Holding Company



## Too much effort to determine tax residency of an entity?

Virtually no CRS implementer follows the tax residency guidance of the CRS Commentary regarding tax residency of entity account holder. CRS commentary pg. 144 – 145 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 & 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.

**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. An untaxed entity may not have a tax residence. In such case, CRS pg 41 par(1)(a) If the Entity certifies that it has no residence for tax purposes, the Reporting Financial Institution may rely on the address of the principal office of the Entity to determine the residence of the Account Holder.



## Microfinance entity is Active NFE if it earns interest?

**OECD defines interest** as earnings on debt claims. Interest is the amount that the debtor becomes liable to pay to the creditor over a given period without reducing the amount of principal outstanding, under the terms of the financial instrument agreed between them.

EU Commission and Model tax conventions define "interest" as meaning income from debt-claims of every kind, whether secured by mortgage and whether carrying a right to participate in the debtor's profits, and, income from government securities and income from bonds or debentures, including premiums and prizes.

Although interest is mentioned as passive income, this refers to earning interest without any activity to earn that income besides investing. Passive income is earnings derived from a in which a person is not actively involved. Microfinance interest is earned by the entity who is actively involved in marketing, finding, vetting debtors. It also involves the active collection of interest.

Microfinance interest is different in nature to passive income earned from a bank deposit or investment in a bond, which is clearly passive (i.e. no active work needed to collect the income). Additionally, collecting interest from microfinance clients is much more labour intensive as loans are small, and collecting from many small debtors has a different characteristic to collecting interest from a bank deposit or government bond.

Therefore, interest earned by a Microfinance entity is not passive income. Therefore, the microfinance entities pass the income test for a Type [A] Active NFE. Microfinance entities pass both the asset test (mostly debtors) and income test (mostly active income collecting interest) to be a Type [A]Active NFE

## Must trustee report on protectors of investment entity trusts if FAQ is not regarded as not obligatory? Must bank report on protectors of NFE trusts if no control?

The OECD's definition in the CRS of an Account Holder in a trust that is a Financial Institution is a person who holds a so-called "equity or debt interest", are defined in the as "a settlor or beneficiary of all or a portion of the trust, or any other natural person exercising ultimate effective control over the trust." Since "Protector" is not mentioned in that definition, the only way a Protector should be an equity interest Account Holder is if it "exercises ultimate effective control over the trust."

Some may opine that a protector does not have such control. However, why should a protector be named as controlling person of Passive NFE trust. Therefore, the OECD CRS FAQ update states a Protector must be treated as an Account Holder of an investment entity trust "irrespective of whether it has effective control over the trust."

Tough luck. It makes perfect sense that Protectors must be reported whether trust is a Passive NFE or an Investment entity. Why should Investment Entity protectors get a break?

**Do not ignore the FAQ** There are lawyers advocating that trustees ignore the FAQ if it is not legislated to follow the FAQ and thus omit reporting of protectors because according to CRS protectors do not have ultimate effective control. Also, lawyers debate whether Protector right to replace trustee is effective control. It doesn't matter, protectors of all trusts whether Passive NFE or Investment Entity must be reported.



# Is it possible to look-through FIs holding Passive NFEs? What about non-participating Custodian, Depository and Insurance Institutions?



CRS pg. 57 Par(D) "Reportable Account" includes an account held by a Passive NFE with one or more Controlling Persons that is a Reportable Person, other than... a Financial Institution. In contrast the OECD CRS FAQ update states "Does the CRS allow a Reporting Financial Institution to not report such Controlling Person on the basis that there is a Reporting Financial Institution in the ownership chain between the Passive NFE and the Controlling Person? No. The CRS status of intermediate Entities in the ownership chain is irrelevant for these purposes." A non-participating FI must be treated as a Passive NFE, subject to look-through only if the FI is an Investment Entity. What if controlling person is another type of FI e.g. Custodian, depository or insurance institution?

As look-through to individual controlling person is based AML in possession, there would be no reporting on say non-participating custodian if reporting FI does not have ultimate beneficiary on file.

## Can a discretionary management agreement on one dollar make the entity an investment entity?

A managed FI is an entity whose assets are managed by an FI and it earns more than 50% of its income over the last three financial years.

CRS Commentary page 161 - 162 The term "Investment Entity" includes two types of Entities: Entities that primarily conduct as a business investment activities or operations on behalf of other persons, and Entities that are managed by those Entities or other Financial Institutions.

Where an Entity is managed by a mix of Financial Institutions, NFEs or individuals, the Entity is considered to be managed by another Entity that is a Depository Institution, a Custodial Institution, a Specified Insurance Company, or an Investment Entity described in subparagraph A(6)(a), if any of the managing Entities is such another Entity.

The word "mix" has no de minimis threshold. Therefore, any amount above zero that is managed by an FI qualifies the entity to be managed by an FI.

Note this management of assets must be on a discretionary basis.

### Puerto Rico US Territory: Erroneously omitted by EU Code of Conduct Group

The EU Code of Conduct Group (Business Taxation) has blacklisted three of the five US territories, but omitted Puerto Rico, the most significant jurisdiction with 94% of the population of US territories and has a huge financial offshore industry geared to assisting avoidance of the Common Reporting Standard.

The EU Code of Conduct Group reasons for placing the small US territories of Virgin Islands, Guam, and Samoa on the blacklist apply equally to Puerto Rico.

- i. Does not apply any automatic exchange of financial information
- ii. has not signed and ratified, including through the jurisdiction they are dependent on, the OECD Multilateral Convention on Mutual Administrative Assistance as amended
- iii. has harmful preferential tax regimes and did not clearly commit to amending or abolishing it,
- iv. does not apply the BEPS minimum standards and
- v. did not commit to addressing these issues by 31 December 2018.

Puerto Rico is the largest of the five US territories with a population of 3.6 million versus a

total of 0.2 million in the other four territories. Critically relevant to the EU blacklist, Puerto Rico has a significant offshore financial centre consisting of International Financial Entities (IFE), Insurers, Custodians, Banks and Brokerages. The IFEs aggressively attract money from Europe for the sole reason to avoid being reported for the Common Reporting Standard. Another benefit being marketed by these IFEs and Insurers is that the US territories are excluded from FATCA reciprocal reporting. The first page of every FATCA IGA agreement defines the USA as being the 50 states and explicitly excludes the US territories of Puerto Rico, Guam, Virgin Islands, Samoa and Northern Marianna Islands.

It is apparent that someone in the CCG made an error to place the largest US territory of Puerto Rico in the list of 3<sup>rd</sup> party countries with no economic data and thus leave Puerto Rico off the black list of uncooperative tax havens.

The EU black list contains three of the five US territories of Guam, US Virgin Islands and Samoa. A quick look at Wikipedia will confirm these are insignificant compared to Puerto Rico which has 12 times the population of all other US territories and a GDP (well over \$120 billion) of 10 x all the other territories.

Not only that, but Puerto Rico has a significant multi-billion offshore finance industry with many shell banks (called IFEs) and insurance companies aimed exclusively at non-residents. Many of these target EU tax-residents exclusively to avoid the Common Reporting Standard. Puerto Rico is not part of FATCA reciprocal reporting. Critically, there is no tax whatsoever on non-residents financial income.

It is incongruent and senseless that the black list contains three tiny US territories but omits the largest territory.

IV. Third Country Jurisdictions with no economic data	Selection indicators (*)		
	STRENGTH of ECONOMIC TIES with the EU	MAGNITUDE of FINANCIAL ACTIVITY in the jurisdiction	STABILITY FACTORS in the jurisdiction
Åland Islands	..	..	..
Bonaire, Sint Eustatius and Saba	..	..	..
Bouvet Island	..	..	..
British Indian Ocean Territory	..	..	..
Christmas Island	..	..	..
Capeverde	..	..	..
Cocos (Keeling) Islands	..	..	..
Heard Island and McDonald Islands	..	..	..
Malaysia / Labuan Island	..	..	..
Norfolk Island	..	..	..
Pitcairn Islands	..	..	..
<b>Puerto Rico</b>	..	..	30.6
Saint Helena, Ascension and Tristan da Cunha	..	..	..
Saint Pierre and Miquelon	..	..	..
South Georgia and the South Sandwich Islands	..	..	..
Tokelau	..	..	..
United States Minor Outlying Islands	..	..	..
Vatican City State	..	..	..
Wallis and Futuna Islands	..	..	..

Permanently inhabited territories			
Name	GDP (dollars)	Population	Area
American Samoa	\$658,000,000	55,519	197 km <sup>2</sup>
Guam	\$5,793,000,000	159,358	549 km <sup>2</sup>
Northern Mariana Islands	\$1,242,000,000	53,457	463 km <sup>2</sup>
<b>Puerto Rico</b>	\$102,135,000,000	3,667,084	9,104 km <sup>2</sup>
United States Virgin Islands	\$3,765,000,000	106,405	346 km <sup>2</sup>



## Why do FIs often wrongly equate listed on stock market as regularly traded?

Because their compliance is incompetent, ignorant or in collusion.

An entity only qualifies for a non-reportable person or an Active NFE whose controlling persons are not reported, if it is **regularly traded**, i.e. listed on an exchange with market cap exceeding USD 1 billion and is regularly traded i.e. each year more than 10% of its stock is sold to unrelated parties each year and market makers buy and sell the stock more than 60 days per year. Yet many FIs, including the largest banks maintaining the assets of family owned entities listed on stock exchanges like in Curacao accept the account holder entity self-certification that it is regularly traded, despite no shares being sold to unrelated parties and certainly not traded at least 60 days a year. This is incompetence or collusion.

## Which countries will likely never join automatic exchange of info

LDC: The OECD has not invited the any jurisdiction on the UNs list of 47 least developed countries, which are low-income countries confronting severe structural impediments to sustainable development. These countries are not on the EU grey list of non-cooperative nations. However, these countries may voluntarily join and be trained by the OECD to implement CRS.

**Disputed States:** However, countries that will never join CRS are those that are not recognised by many of UN members.

Primarily, these States are neither UN members nor UN observers such as:

- Kosovo
- State of Palestine
- Republic of South Ossetia
- Republic of Abkhazia
- Republic of Artsakh
- Transnistria
- **Republic of China – Taiwan** (China to pressurise them to implement CRS, has 30+ double tax treaties, signed FATCA, has CRS legislation)

## What is habitual residence in determining tax residence?

Mainly physical stay of 183 days per year

Is also determined by the voluntary habitual dwelling of a person in a given place, so that both the objective aspect of the stable dwelling in that place and the subjective aspect of the willingness to remain in such place meet the definition of residence. Neither the continuity nor the permanence thereof is required for the condition of habitualness of the abode to exist.

Consequently, the habitualness of the abode remains when the person works or carries on other activities outside the municipality of residence, provided he keeps his abode therein, returns thereto whenever possible, and discloses the intention to keep therein the centre of own family and social ties.

Residence is not invalidated by absences due to special needs deriving from contemporary lifestyles, such as study, work, care, or leisure reasons.

## Too much effort to determine tax residency of controlling person?

FI may claim that he does not know if client has other tax residencies if client certifies he does not have another permanent home.

It is relatively simple for an FI to determine other potential residencies based on the OECD Model Convention (MC) on residency. It is not the FIs task to determine which single jurisdiction has the sole claim on tax on the client based on double tax agreement tiebreakers. The FI must just determine the indicia that a client is tax resident in a jurisdiction.

The list of questions below, based on the OECD MC will help determine indicia of where the client has potential tax residencies. Thereafter, the client may cure these indicia. Otherwise CRS reporting will be sent to all the jurisdictions.

Additionally, the FI should use reasonableness in determining if other residencies exist. It is implausible that a multi-millionaire is living in a cheap apartment, or that client cannot show stamps in passport indicating travel.

I. DETERMINE PREVIOUS TAX RESIDENCES	Rbi Country	Country B	Country C
Since October 2014, which jurisdictions resident prior to current Rbi / Cbi?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

II. DETERMINE PERMANENT HOMES	Rbi Country	Country B	Country C
Where do you have access to an owned or rented dwelling, available at all times continuously?	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

III. CENTRE OF VITAL INTERESTS	Rbi Country	Country B	Country C
<b>Social relations</b>			
Family - Immediate, nuclear (Children go to school)	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Political associations	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cultural relationship of shared group identity which can be reasonably traced historically	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Driving license issued	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Clubs - health, sports, leisure	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Where health insurance issued	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Doctor	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<b>Economic Relations</b>			
Place of business	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Attendance of business meetings	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Executive appointments	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Hotel business expenses	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Crediting of income realised	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Place administers property	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ownership of movable goods - furniture, art, vehicles	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

IV. HABITUAL ABODE	Rbi Country	Country B	Country C
Works or carries on other activities outside the municipality of permanent residence, provided keeps abode therein, returns thereto whenever possible, and discloses the intention to keep therein the centre of own family and social ties	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Physical stay of at least 183 days per year (Check passport stamps)	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

V. EXISTING CRS INDICIA	Rbi Country	Country B	Country C
One or more telephone numbers in a Reportable Jurisdiction	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Current mailing or residence address (including a post office box) in a Reportable Jurisdiction;	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Standing instructions (other than with respect to a Depository Account) to transfer funds to an account maintained in a Reportable Jurisdiction	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Currently effective power of attorney or signatory authority granted to a person with an address in a Reportable Jurisdiction	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
A hold mail instruction or in-care-of address in a Reportable Jurisdiction	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

VI. CURING RESIDENCE INDICIA	Rbi Country	Country B	Country C
Tax clearance certificate or equivalent	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Indicia of other tax residencies	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
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**mark.morris@the-  
best-of-both-  
worlds.com**

**+41 76 212 20.24**

## Upcoming publications

a sprinkling of topics in  
future issues...

- Taiwan
- Tax residencies of tax transparent entities
- What is reported or not reported if jurisdiction aligns beneficiaries of NFE trusts with investment entity
- Wound up investment entity, who reports
- Fake high-volume trading to make listed entity a regularly traded
- What is difference between a non-reportable person and an Active NFE that are central banks, Government entities international organisations, regularly traded entities
- Can you fake an Active NFE charity?
- Active NFE reorganization other than emerging from bankruptcy



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