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OPINION BRIEF ON BENEFICIAL OWNER FOR CRS PURPOSES ON TCI HYBRID ENTITIES

I. TURKS & CAICOS HYBRID ENTITY HAS SHAREHOLDER(S) WHO ARE NOT ENTITLED TO BENEFITS AND GUARANTEED MEMBERS WHO ARE NOT SHAREHOLDERS BUT ARE ENTITLED TO THE FLOW OF BENEFITS.

II. ARE THE GUARANTEED MEMBERS CONSIDERED AS THE BENEFICIAL OWNERS?

According to the Common reporting Standard as well as the FATF recommendations on beneficial ownership, the natural persons who are Guaranteed Members will be considered as the beneficial owners.

I. Summary of Turks & Caicos Hybrid Companies for OECD Common Reporting Standard

Specialist opinion is sought concerning the Controlling Persons of TCI Hybrid companies which are NFEs or Equity Interest of TCI Hybrid companies that are categorised as Investment Entities.

A TCI Hybrid company is functionally equivalent to a trust because Guarantee Members carry no rights to vote but have all the rights to participate in the income and capital of the company.

Similarly, a TCI Hybrid company is also functionally equivalent to a partnership which has a limited partner (The TCI Shareholder) and General partners (The TCI Guarantee Members).

In either of these interpretations the beneficial owner of the TCI Hybrid is the Guarantee Members.

If TCI Hybrid is categorised for CRS purposes as a Non Financial Entity (NFE)

The Controlling persons would be either:

- i. The **Guarantee Members** being equivalent to the discretionary beneficiaries of a trust and the FI maintaining the TCI Hybrid entity would report on the Guarantee members regardless of distribution, or
- ii. The **Guarantee Members** being equivalent to partners because they have all the rights to participate in the income and capital of the company.

If the TCI is categorised for CRS purposes as an Investment Entity

Those having Equity Interest in the TCI Hybrid would be the Financial Account subject to review and reporting if they are reportable persons. Equity interest in the TCI Hybrid is considered:

- i. The **Guarantee Members** equivalent to the discretionary beneficiaries of a trust and the FI maintaining the TCI Hybrid entity would report on the Guarantee members upon distribution, or
- ii. The term “Equity Interest” means, in the case of a partnership that is a Financial Institution, either a capital or profits interest in the partnership which would be the **Guaranteed Members**.

There is no hybrid or unique structure where benefits are inured to a natural person, but that natural person is not considered as the beneficial owner.

II. Background on TCI Hybrid

A company that is limited both by shares and by guarantee and therefore has two classes of member:

- a) **Shareholders**, and
- b) Guarantee Members

Directors elect a Guarantee Member into membership of the company on condition that the member undertakes to contribute to the debts of the company up to a certain specified maximum amount, typically US\$100 or less. As such a Guarantee Member holds a contingent liability. This contrasts with the position of the shareholder who holds an asset – the shares.

The rights and obligations which attach to each class of membership can be laid down in the Articles of Association of the company or by the directors in board meetings, thereby keeping the terms and conditions of membership confidential. The arrangements that can be made are infinite and flexible. Skilful drafting can be used to attach different rights and obligations to each class of membership and create structures that are precisely tailored to the different needs of the client.

Hybrid companies are often used as “quasi trusts”, particularly by persons resident in Civil Law countries where trusts are not recognised. Typically, the company will be structured so that the

- a) **Shares are issued on terms that each carries one vote but no rights to dividends or to participate in the capital or income of the company.**

M201 TCI Hybrid Company for CRS purposes

b) The Guarantee Memberships would be issued on terms that they carry no rights to vote but all the rights to participate in the income and capital of the company. Thus all control rests with the shareholders but all **benefits** flow to the Guarantee Members.

The shares can be issued to professional managers but, unlike normal shareholders, they cannot receive financial benefit from holding the shares and therefore must act as quasi trustees.

All financial **benefits** flow to the Guarantee Members who are therefore in a position **not unlike the beneficiaries of a trust.**

The anti-avoidance legislation enacted by many onshore countries aims to tax the undistributed or untaxed profits of low tax paying companies as though those profits have been received by the shareholders. Although the legislation differs by country, it generally focuses on the percentage of shares held or the control of the company if that control is achieved other than through the ownership of shares. Under the arrangements outlined above, the Guarantee Members would not own shares or have control of the company so it may be that this type of anti-avoidance legislation is ineffective in taxing profits rolled up within a hybrid structure. It will generally also be the case that a hybrid structure does not entail any reporting requirement for the Guarantee Members so that, on a practical level, unwanted attention from onshore revenue authorities can be avoided. *(This entire paragraph is irrelevant for CRS – edit Mark Morris*

A Guarantee Member would normally be issued with a membership certificate, but this does not constitute a share, stock or security.

1 **III. FATF RECOMMENDATIONS 10 and 25 ON BENEFICIAL OWNERSHIP** 1

2 [http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-](http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf) 2
3 [ownership.pdf](http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf) 3

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5 **LEGAL ARRANGEMENTS** 5

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7 18. The FATF definition of beneficial owner also applies in the context of 7
8 legal arrangements, meaning the natural person(s), at the end of the chain, who ultimately 8
9 owns or controls the legal arrangement, including those persons who exercise ultimate 9
10 effective control over the legal arrangement, **and/or the natural person(s) on** 10
11 **whose behalf a transaction is being conducted.** However, in this context, 11
12 the specific characteristics of legal arrangements make it more complicated to identify the 12
13 beneficial owner(s) in practice. 13
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IV. OECD Common Reporting Standard on beneficial owners of trusts, partnerships and functional equivalent entities

CRS page 178 par 68 Subparagraph C(4) – Equity Interest

The definition of the term “Equity Interest” specifically addresses interests in partnerships and trusts. In the case of a partnership that is a Financial Institution, the term “Equity Interest” means a capital or profits interest in the partnership. In the case of a trust that is a Financial Institution, an “Equity Interest” is considered to be held by any person treated 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. **The same as for a trust that is a**

Financial Institution is applicable for a legal arrangement that is equivalent or similar to a trust, or foundation that is a Financial Institution.

Where a Reporting Financial Institution relies on information collected and maintained pursuant to AML/KYC Procedures for purposes of determining the Controlling Persons of an Account Holder of a New Entity Account (see subparagraph A(2)(b) of Section VI), such AML/KYC

Procedures must be consistent with Recommendations 10 and 25 of the FATF Recommendations (as adopted in February 2012), including always treating the settlor(s) of a trust as a Controlling Person of the trust and the founder(s) of a foundation as a Controlling Person of the foundation. For purposes of determining the Controlling Persons of an Account Holder of a Preexisting Entity Account (see subparagraph D(2)(b) of Section V), a Reporting

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1 Financial Institution may rely on information collected and maintained pursuant to the 1
2 Reporting Financial Institution’s AML/KYC Procedures. 2

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5 CRS page 45 5

6 The term “Financial Asset” includes a security (for example, a share of stock in a 6
7 corporation; partnership or beneficial ownership interest in a widely held or publicly traded 7
8 partnership or trust; note, bond, debenture, or other evidence of indebtedness), partnership 8
9 interest, commodity, swap (for example, interest rate swaps, currency swaps, basis swaps, 9
10 interest rate caps, interest rate floors, commodity swaps, equity swaps, equity index swaps, 10
11 and similar agreements), Insurance Contract or Annuity Contract, or any interest (including a 11
12 futures or forward contract or option) in a security, partnership interest, commodity, swap, 12
13 Insurance Contract, or Annuity Contract. 13
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17 CRS page 51 17

18 The term “Equity Interest” means, in the case of a partnership that is a Financial Institution, 18
19 either a capital or profits interest in the partnership 19
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CRS page 57

The term “**Reportable Jurisdiction Person**” means an individual or Entity that is resident in a Reportable Jurisdiction under the tax laws of such jurisdiction, or an estate of a decedent that was a resident of a Reportable Jurisdiction. For this purpose, an Entity such as a partnership, limited liability partnership or similar legal arrangement that has no residence for tax purposes shall be treated as resident in the jurisdiction in which its place of effective management is situated.

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Dated this, the 27th day of October, 2016



Mark Morris

===== **END OF BRIEF** =====