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Financial Institutions

U.S. Multinational Banks Face Huge CRS Challenges as Early-Adopter Deadline Nears

U.S. multinational banks are facing big challenges and uncertainties as the deadline for the Organization for Economic Cooperation and Development's standard for global automatic information exchange rolls closer.

Dozens of countries have signed on to participate in the common reporting standard, which calls for each jurisdiction to share information on financial accounts with many others. Early-adopter countries must start implementing the CRS on Jan. 1, 2016—a date U.S. companies should be watching carefully.

The standard could have an enormous impact on U.S. multinationals even though—and perhaps because—the U.S. hasn't formally committed to it, practitioners and an OECD official told Bloomberg BNA in a series of interviews.

"It may be true that the U.S. hasn't implemented CRS yet," said John Staples, managing partner of the U.S. office of Burt, Staples & Maner LLP. "But it's an immediate issue for any big bank such as State Street or Citibank. The implementation problem for large U.S. financial institutions is here now."

Challenges. Those institutions are faced with CRS reporting obligations in all jurisdictions where they do business and that have agreed to adopt the standard. Practitioners called this a tremendous challenge for companies already faced with reporting U.S.-owned accounts in their foreign branches under the U.S. Foreign Account Tax Compliance Act, because the information required under FATCA and the CRS isn't the same.

In addition to this, U.S. multinationals may be dealing with treatment of their cross-border investment entities as passive non-financial foreign entities (NFFE) in countries that have committed to the standard. This will likely happen only if the U.S. is considered non-participating by adoptees—a position already taken by the U.K. but questioned by some practitioners.

Controlling Owner Disclosure. Under the CRS, U.S. investment entities doing business in countries that have adopted the CRS could face look-through treatment by those jurisdictions to identify their controlling persons—an outcome that could hurt the U.S. fund industry, among others, practitioners said.

Philip Kerfs, head of OECD's International Cooperation Unit within the Center for Tax Policy and Administration, said even with CRS jurisdictions still working

on bilateral agreements, the U.S. could be treated as non-participating on a broader scale if it doesn't specifically commit. "It may well be that other countries take that position" in a world where global transparency is rapidly growing, Kerfs said.

The common reporting standard has its roots in the accords negotiated under FATCA, as jurisdictions around the world saw the transparency benefits of the U.S. law and moved to widen its scope.

FATCA requires foreign financial institutions to report U.S.-owned accounts to the Internal Revenue Service or face, in some cases, a 30 percent withholding tax on their U.S.-source income. This also affects large U.S.-based multinationals that do business around the world.

Broader CRS Reporting. However, the CRS calls for somewhat different—and in some cases broader—information to be reported between countries than the data required under FATCA's intergovernmental agreements (IGAs). While the CRS doesn't carry the threat of withholding, it also doesn't have the de minimis threshold of accounts worth more than \$50,000 that FATCA does.

Many big financial institutions felt they have done all of this work for FATCA and don't have to be as concerned about CRS. Now they are recognizing this is going to be a substantial amount of work on top of what they've already done.

The differences between the information needed under FATCA and under the CRS may be a tough hurdle for the U.S. in adopting the CRS, with action by lawmakers likely needed to allow the U.S. to participate, practitioners said.

"That would require legislation to go through Congress," said Michael Plowgian, a principal in the international tax group of KPMG LLP's Washington National Tax Practice. Given the current environment on Capitol Hill, "that's unlikely to happen," adding that there have even been difficulties getting legislation passed that would allow the U.S. to fully participate in information exchange under the FATCA agreements.

Kerfs said it is his understanding that in the U.S., "the process to get this adopted may be challenging and take some time." He said there is an acknowledgment

Comparison of FATCA Model 1 Intergovernmental Agreements (“IGAs”) and Agreements under the Common Reporting Standard (“CRS”)

Form of agreement

IGA

Model 1 IGAs are usually an agreement between U.S. and another jurisdiction with which the U.S. can exchange information on an automatic basis. IGAs are bilateral but can provide for reciprocal exchange of information or unilateral reporting to U.S.

CRS

Agreement implementing CRS is a competent authority agreement entered into pursuant to an income tax treaty or the Convention on Mutual Administrative Assistance in Tax Matters. Provides for reciprocal exchange of information, but can be bilateral or multilateral.

Purpose of agreement

IGA

IGA provides the means for U.S. to obtain information required under FATCA. In exchange for IGA partner providing this information, U.S. doesn't impose FATCA withholding on the IGA partner's financial institutions and, in the case of reciprocal Model 1 IGAs, provides certain information automatically to IGA partner.

CRS

Each party to the agreement commits to collect certain information from its financial institutions and to provide to its partner jurisdiction information related to residents of the partner jurisdiction. The benefit to each party is automatically obtaining information about its residents with financial accounts in other jurisdictions.

Burden of agreement

IGA

In non-reciprocal IGAs, burden is entirely on IGA partner. In reciprocal IGAs, U.S. has lesser burden than IGA partner because it commits to collect and exchange less information than IGA partner.

CRS

Each party takes on identical collection and exchange burdens.

Scope of information reported by financial institutions and exchanged by tax authority in one jurisdiction to another

IGA

IGA partner's financial institutions have to report, and IGA partner has to exchange, information required by FATCA regarding financial accounts of specified U.S. persons and accounts of entities controlled by specified U.S. persons. U.S. only commits to report information about income that it collects under current law. Note that IRS needs legislation to be able to meet its obligations under a reciprocal IGA.

CRS

Each party agrees to exchange information analogous to that required by an IGA partner plus certain additional information (e.g., date of birth of account holder, if collected under current rules) and without some exceptions that apply under FATCA (e.g., regularly traded interests in investment entities).

Due diligence required of financial institutions

IGA

Annex I of IGA sets forth specific procedures for pre-existing and new accounts, and accounts held by individuals and entities.

CRS

Similar to IGA procedures, but without \$50,000 thresholds for pre-existing individual accounts and without U.S.- and FATCA-centric rules of IGA.

Commencement of reporting

IGA

Reporting is phased in over a three-year period, beginning with the 2014 tax year.

CRS

Full reporting, based on commitment date.

Notable features

IGA

Because U.S. taxes on basis of citizenship, financial institutions have to look for indicia of U.S. citizenship and not just residency in their due diligence.

CRS

Intended to work multilaterally, and so may result in countries getting more or less information than they would request in a negotiated bilateral agreement.

Means of enforcing agreement (and incentives to maintain confidentiality of information exchanged)

IGA

Threat of U.S. imposing withholding under FATCA if U.S. suspends or terminates IGA.

CRS

Potential loss of information from partner jurisdiction if agreement were canceled or suspended.

Consequences of failure to comply with agreement

IGA

U.S. will impose FATCA withholding in extreme cases or terminate IGA (which would require financial institutions to report information directly to IRS). Little incentive for IGA partner to terminate agreement in light of impact on its financial institutions.

CRS

Loss of information about its residents' financial accounts in partner jurisdiction.

that the U.S. government doesn't have the ability to push the CRS through quickly in the way that some other jurisdictions do.

Sixty-one jurisdictions—including Australia, Canada, Costa Rica, Chile, India and Indonesia—have signed a multilateral competent authority agreement to begin implementing the OECD standard starting Jan. 1, 2016. Many others have promised to adopt it later, for a total of 94 countries agreeing to the CRS so far. Kerfs said he expects more countries to sign the multilateral pact toward the end of 2015.

However, the OECD official said none of the jurisdictions that agreed to take part in the CRS have yet negotiated the bilateral agreements that the standard calls for in order to exchange information. With that process ongoing, "it's very difficult to apply the requirements strictly right now," he said.

OECD Handbook Approved. Kerfs said the OECD is hoping to address some of the questions raised by this transitional stage through a CRS implementation handbook approved recently by the Committee on Fiscal Affairs.

He said the handbook takes an approach similar to—but not the same as—the U.K. by allowing countries to view other jurisdictions as participating or not participating based on whether they have committed to the CRS, rather than on whether they have negotiated an agreement.

However, Kerfs stressed that unlike the U.K., the handbook carries a requirement that countries must reach their bilateral agreements by July 1, 2017—and they must start exchanging information by 2018—or they won't be considered as participating.

Standards for Participation. Kerfs also said the handbook has careful standards on when jurisdictions are allowed to determine whether other countries are participating if they haven't reached the necessary accords. "The idea is not that countries can just make their own decisions," he said.

The handbook describes "quite clearly" that for a jurisdiction to be considered as participating, it must have made a public commitment at the government level.

With the OECD's two-year window for the agreements to be reached, "I'm not sure it would be a benefit to these U.S. companies to be treated as in a participating jurisdiction, if two years down the road the U.S. hasn't committed," Kerfs said. "It's a bit of a strange issue right now."

He said in the longer term, a process is being developed by the Global Forum for reviewing countries to see if they are fulfilling their obligations under the CRS. That system will take time to implement because the first actual exchange of information under the standard won't begin taking place until 2017.

Debate Ongoing. U.S. status is "a debate that's ongoing," KPMG's Plowgian said. Some feel it is unlikely the U.S. would ever be broadly lumped into the non-participating category despite the U.K.'s action.

"I don't see that happening practically or politically," Staples said, given that the U.S. is the birthplace of FATCA, the foundation of the common reporting standard.

John Harrington, a partner at Dentons, called it a "difficult situation." On one hand, if the U.S. hasn't agreed to follow the standard, "that is the literal de-

scription of a jurisdiction that is not committed to CRS," he said. On the other, it would be "bizarre" if the U.S. received that treatment from other countries, he added.

'No Good Answers.' "Ultimately, they have to find some way to acknowledge and reconcile the fact that the IRS is following FATCA," Harrington said. "The U.S. has a system that is set up and working, while CRS doesn't. There are no good answers here."

Denise Hintzke, global FATCA tax leader at Deloitte Tax LLP, said that although the Treasury Department has been "very vocal that the U.S. shouldn't be treated as non-participating because they have FATCA," that argument may fall on deaf ears in some cases.

"I don't know that any of the participating countries have bought into it," Hintzke said.

Impact on Funds. She said the biggest impact of a decision that the U.S. is non-participating could be on the U.S. fund industry, "to the extent they have investment entities outside the United States."

Plowgian gave an example of a U.S. mutual fund with an account at a U.K. bank. Under the CRS, that bank would "look through" the fund to identify its significant owners, and then report them to the U.K. tax authorities. In turn, the U.K. could give that information to the U.S.

"For U.S. investors, it means that they could be reported to the IRS via this exchange from the U.K.," he said. "There's a potential for duplicate reporting or misleading reporting."

As one example, investment managers could be incorrectly identified as controlling people when they're not, Plowgian said, adding that this could happen to entities such as mutual funds, trusts and private equity funds.

Difficulties Ahead. All the practitioners interviewed by Bloomberg BNA said even apart from the risk that the U.S. will be treated as non-participating, multinationals are now realizing they face big challenges.

"People are really scrambling to get their due diligence right and it's frightening."

CYRUS DAFTARY
BURT, MANER & STAPLES LLP

"I think a lot of the bigger financial institutions were of the opinion that they've done all of this work for FATCA and they don't have to be as concerned about CRS," Hintzke said. "Now they're recognizing that they've got this looming project out there that is going to be a substantial amount of work on top of what they've already done."

Staples said that time is of the essence as the Jan. 1, 2016, date nears for early-adopter countries to begin implementing the standard, even though the actual reporting isn't set to start until 2017.

U.S. multinationals in those countries "will be immediately subject to it come the end of the year," he said. "This isn't like some abstract thing in the United States."

Responsibilities ‘Frightening.’ Cyrus Daftary, of counsel at Burt, Maner & Staples LLP, said many U.S. taxpayers are fearful that they won’t be able meet the obligations of both FATCA and the CRS.

“People are really scrambling to get their due diligence right and it’s frightening,” Daftary said. “There are operational burdens in multiple jurisdictions, including privacy jurisdictions. What happens if you get conflicting information? It’s keeping a lot of people up at night.”

Both Plowgian and Susan Grbic, a tax partner and tax practice leader for FATCA and financial services at WeiserMazars LLP, said the lack of guidance in the CRS countries is going to be a big issue as the standard takes effect. “There’s a question of whether all these countries will have published guidance in time,” Grbic said.

CRS Seen as More Complex. Grbic said the CRS is going to be much more complex to comply with than FATCA. The CRS is “much, much larger” than FATCA, she said.

While the standard as envisioned by the OECD has no minimum threshold for accounts to be reported,

there is “the flexibility to create thresholds from country to country,” she said. “It’s very difficult.”

The CRS focus on residency rather than citizenship is yet another hurdle, Grbic said. “I think financial institutions are on their own as to how to report and track residency,” she said. “People do move around. It’s not static like citizenship.”

Cost of Compliance. Peter Bible, chief risk officer for accounting firm EisnerAmper LLP, also said the concern for the U.S. is the broader dollar limits for accounts to be reported and the wider swath of accounts that would have to be reported.

He said that the cost of the CRS could hurt the financial services industry, where companies tend to operate on a very thin margin.

In the bigger picture, as both FATCA and the CRS move ahead, “I think eventually we will get to a global answer to tax evasion,” Bible said.

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