Global Wealth Management

Switzerland

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CRS Implementation: Five Things To Think About Before 2017

The Organisation for Economic Cooperation and Development (the "OECD") released the Common Reporting Standard for Automatic Exchange of Financial Account Information in Tax Matters ("CRS" or the "Standard") on 21 July 2014. Since then, the OECD has published commentaries to the Standard, as well as additional guidance aimed at assisting committed jurisdictions and affected financial institutions in dealing with the implementation and impact of the Standard.

Over 50 "early adopter" jurisdictions committed to implement the Standard into their local law beginning on 1 January 2016 and many of these jurisdictions have done so. Now, many other jurisdictions are set to implement the Standard from the beginning of 2017, and the early adopter jurisdictions are moving towards the first financial institution information reports and the first tax authority information exchanges in the second half of 2017. The global, multilateral exchange of financial account information developed by key jurisdictions and the OECD following enactment by the United States of the Foreign Account Tax Compliance Act ("FATCA") has finally come to fruition. Individuals, families, banks, and other financial institutions need to be well informed, competently advised, and thoroughly prepared leading up to the New Year. Following are five key aspects of CRS implementation of which both financial institutions and wealth owners should be aware.

1. Timing considerations

Countries are typically divided into two groups – "early adopters" and "late adopters" – with a relatively even split between the 101 jurisdictions that have committed to implementing the Standard. Jurisdictions including nearly all the EU Member States, the Cayman Islands, Jersey, Mexico, etc. have committed to implementing the Standard from 1 January 2016, while other jurisdictions such as Switzerland, Canada, Australia, Austria, Singapore, Russia, etc. have committed to implementing the Standard from 1 January 2017. However, this simple delineation does not fully explain where and from what point in time an automatic exchange of relationship is in force.

To properly identify the implications of reporting under the Standard, wealth owners and their advisers must understand the different timetables that jurisdictions have selected for implementation, as well as the technical aspects of the multilateral and bilateral information exchange relationships. When the Standard is implemented locally and when a particular automatic exchange of information relationship is made effective between two jurisdictions can have a critical impact on the timing of information reporting. In the case of account closures, the timing of information exchange can also impact what information will be reported or whether any information is reported at all.

The OECD has released a helpful look-up tool that allows the user to see the bilateral exchange relationships that have been activated. This tool is in development and does not yet list all relationships. The OECD has stated that

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the look-up tool will be updated as further jurisdictions activate exchange relationships.

Switzerland, for example, has concluded and jointly announced numerous bilateral automatic exchange relationships, many of which will not actually enter into force until 1 January 2018 (i.e., one year after their "commitment" date). Additionally, other jurisdictions appear to have fallen behind their targeted implementation dates. Some jurisdictions should drop from "early adopter" to "late adopter" status.

Advisers and wealth owners cannot rely on a particular jurisdiction's date of commitment to predict whether and what information will be exchanged by a particular financial institution or tax authority. With early adopters moving towards their first exchanges next year, it will be important to understand which jurisdictions have or will meet their commitment dates. Other jurisdictions may miss their targets or choose to implement at a later date (as in the case of some Swiss bilateral exchanges), all of which makes identifying the appropriate effective dates more difficult and more important.

2. Due diligence considerations

Both financial institutions and wealth owners should be aware of upcoming measures being taken for the due diligence review of financial accounts. Financial institutions affected will include trusts (and their trustees) and fiduciary services providers, as well as banks, asset managers, investment advisers, and others. All wealth owners with financial assets in managed or passive structures could be affected, with the timing (as noted above) adding another layer of complexity to when and how due diligence reviews are conducted.

Financial institutions in early adopter jurisdictions should already have: (1) begun the due diligence review (including requesting Account Holder documentation and self-certifications) of their Preexisting Accounts, which in most jurisdictions include those accounts opened prior to 1 January 2016 and still in existence on that date; and (2) put in place due diligence documentation procedures for New Accounts opened on or after 1 January 2016.

Financial institutions in late adopter jurisdictions (i.e., with first reporting in 2018 or later) will institute the same procedures for Preexisting Accounts and for New Accounts. However, the implementation and cut-off dates will be different. Generally, Preexisting Accounts will include those accounts open prior to 1 January 2017 and still in existence on that date, while New Accounts will be accounts opened on or after 1 January 2017.

For financial institutions in both early adopter and late adopter jurisdictions, the level of due diligence review to apply will also depend on whether their jurisdiction has chosen to adopt the "Wider Approach" or the "Normal Approach" to CRS implementation. For those adopting the Wider Approach, financial institutions should be able to review all accounts in the same manner and the cut-off date for Preexisting Accounts should be the same with respect to all Account Holders, even if they are resident in a non-Reportable Jurisdiction. For those jurisdictions adopting the Normal Approach, the due diligence review and deadlines would not be triggered until the reporting and reportable jurisdictions have in effect an agreement to implement the standard. In some jurisdictions, including Switzerland, financial institutions may have the option to choose between the Wider Approach and the Normal Approach. These financial institutions should consider carefully their options and the due diligence consequences for each. Account Holders should also be prepared for the start of due diligence review procedures. New Account

Holders will need to be ready to provide self-certifications of their tax residence and CRS status. For Entity Account Holders, this will mean determining their CRS status prior to providing self-certification forms to requesting financial institutions.

Account Holders should also be prepared for follow-up inquiries from financial institutions that may have questions regarding the tax residence information or CRS status claimed. Some particular areas of which Account Holders should be aware are the following:

- Questions where a Taxpayer Identification Number ("TIN") cannot be provided, including where a TIN is not issued by the jurisdiction of tax residence
- Identification and self-certification of Controlling Persons
- Supporting the classification of Entity Account Holders where documentation is unclear or does not support such classification
- Classification of entities with managed accounts
- Application of specific categories of Active Non-Financial Entities or Non-Reporting Financial Institutions

Finally, reporting financial institutions in early adopter jurisdictions should have already completed the implementation of IT and data collection systems, to ensure timely compliance with their due diligence obligations. Reporting financial institutions in late adopter jurisdictions should be well on their way toward full implementation of such systems. Any reporting financial institutions that have not made progress in systems implementation should take action now to ensure timely implementation of the necessary due diligence procedures.

3. Mechanics of account openings and closures

As noted above, countries will be divided into two groups: early adopters and late adopters. This distinction is important when it comes to determining which due diligence review procedures will need to be undertaken by financial institutions.

Early adopter financial institutions will need to report account balances as of 31 December 2016 for both Preexisting Accounts and New Accounts that remain open as of the end of 2016. These balances will have to be determined and collected along with other information regarding reportable accounts before the first applicable reporting deadline in 2017. In the event that an account was closed in 2016, the Standard requires only the fact that the account was closed to be reported; the account balance or value upon closure is not required to be reported under the Standard as it is under the Model 1 FATCA Intergovernmental Agreements.

Late adopter financial institutions will need to report account balances as of 31 December 2017 for both Preexisting Accounts and New Accounts that remain open as of the end of 2017. Those balances will have to be determined and collected along with other information regarding reportable accounts before the first applicable reporting deadline in 2018. Additionally, as with reporting in early adopter jurisdictions, the balance of an account closed in 2017 is not reported. As noted above, for late adopter financial institutions, Preexisting Accounts include those in existence prior to 1 January 2017. Therefore, if an account maintained in a late adopter jurisdiction is closed in 2016, it will not be considered to be a Preexisting Account subject to reporting by a late adopter jurisdiction.

4. Special issues related to trusts

The Standard applies broadly to “Financial Institutions” and “Financial Accounts,” and both terms impact trusts in a unique and sometimes unexpected way. For instance, the “Equity Interests” in a trust determined to be an “Investment Entity Financial Institution” are treated as Financial Accounts potentially subject to CRS reporting. Equity Interests in a trust are 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. A discretionary beneficiary will be treated as holding an equity interest (and, thus, potentially reportable) only in the years in which the beneficiary receives a distribution.

The absence of a distribution to a discretionary beneficiary in a year after the year in which distribution was made does not constitute an account closure. However, the death of a settlor (or another person treated as holding an equity interest in a trust) will constitute an account closure required to be reported as such under the Standard. Additionally, the removal of a beneficiary or a trustee will also constitute an account closure where those persons are treated as holding Equity Interests in the trust. As noted above, jurisdictions that have committed to be early adopters have selected 1 January 2016 as the date from which financial institutions in their jurisdiction will apply the New Account due diligence procedures. Conversely, for trusts resident in late adopter jurisdictions, any changes to the equity interests in the trust that take effect before 1 January 2017 will not factor into potential CRS reporting determinations.

For a trust classified as a “Non-Financial Entity” or “NFE,” the trust itself and any Controlling Persons of the trust may be subject to CRS reporting by a financial institution that maintains a financial account held by the trust. In general terms, Controlling Persons of a trust include the settlor(s), trustee(s), beneficiary/ies, protector(s) and any other natural person exercising ultimate effective control over the trust. As noted above, when the Financial Account held by the trust is closed during the year the fact of the closure must be reported. The OECD has emphasized that it is necessary to consider Controlling Persons at the time assets are contributed to the trust and not at the time that the report is being prepared. It is therefore important for trustees, advisers, and wealth planners to carefully review current trust structures, as well as the local legislation and guidance implementing the Standard, to correctly identify who may be required to report and who may be the subject of such reporting in connection with a trust.

5. What is reportable? When?

Beginning in the spring of 2017, financial institutions in early adopter jurisdictions will be required to conduct their first reporting under the Standard. This reporting will include sufficient information to allow the receiving jurisdiction to identify the Account Holders, as well as information identifying the reportable Financial Account and the reporting financial institution. Also include in reporting will be information related to payments made on an account and the account balance as of 31 December 2016. As previously noted, however, for accounts closed during 2016, the account balance at closing is not required, only the fact that the account was closed.

It is important to note that the financial income information being provided by reporting financial institutions is determined under the tax laws of the jurisdiction collecting the information. These laws may differ from the tax laws of the jurisdiction in which the Account Holder is resident. While administrative convenience may necessitate the use of the reporting financial institution's own tax laws, the information transmitted may be of little use or may be confusing to the tax authority of a receiving jurisdiction with substantially different tax laws.

Perhaps more worrisome to wealth owners, such transmissions may result in challenges by the receiving jurisdiction's tax authorities of income information that is inaccurate or incomplete either under the laws of the taxpayer's home country or in the context of the situation. For example, each holder of a jointly-held account is attributed the entire balance or value of the joint account, as well as the entire amounts paid or credited to the account. Reconciling this information when all Account Holders reside in the same jurisdiction may not be too difficult. In situations where the Account Holders reside in different jurisdictions, on the other hand, individuals and families may face additional challenges and administrative burdens to ensure they are only taxed on their respective interests in the account. Keeping accurate records of account ownership and working with local tax return preparers and legal advisers to ensure proper reporting may help minimize any troubles with local taxing authorities.

6. Next steps

Financial institutions in early adopter jurisdictions should already have in place their CRS due diligence procedures and systems and should have made significant progress in their review of Preexisting Accounts. They should also have all required documentation for reporting with respect to New Accounts and be ready for reporting in 2017.

Financial institutions in late adopter jurisdictions should also be well on their way toward implementing due diligence procedures and systems to begin documentation of New Account Holders from 1 January 2017, and to begin their review of Preexisting Accounts. These financial institutions should also not delay in looking forward to reporting starting in 2018 or later.

Wealth owners in all jurisdictions should carefully review their structures and be ready for compliance with the new CRS reporting requirements. Such readiness includes understanding and properly classifying structures, having compliance procedures in place for trusts and companies that may be classified as financial institutions, and being prepared to provide the required documents to other financial institutions when required. Finally, wealth owners should carefully consider how to respond to reporting depending on the countries involved.

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