



# **OECD's *Handbook for Implementation of the CRS*: TJN's preliminary observations\***

Andres Knobel

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## **1. Introduction and background**

The OECD, a club of rich countries that dominates rule-setting for global financial transparency standards, is in the process of rolling out a new global tool for countries to co-operate in fighting the scourge of tax evasion, known as the [Common Reporting Standard \(CRS\)](#).

This report analyses the OECD's [Implementation Handbook](#) for the CRS, published as part of a package in August 2015. This is the latest of several milestones:

- **Feb 2014:** OECD announces the new standard for Automatic Information Exchange (AEOI, see Box), containing the CRS and a model Competent Authority Agreement (CAA).
- **July 2014:** the OECD publishes the [Commentaries to the CRS](#), providing more in-depth details and interpretations of the CRS.
- **August 2014:** the OECD Global Forum publishes a [Roadmap](#) for developing countries, following criticism that they had been rather left out.
- **Oct 2014:** the OECD publishes the [Multilateral Competent Authority Agreement](#) (MCAA) to implement the CRS, then signed by 51 jurisdictions.

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\* This is a preliminary legal and political analysis of the Handbook published in August, 2015. To contact us about this paper, please write to [andres@taxjustice.net](mailto:andres@taxjustice.net). Thanks to Mark Morris and other experts for their feedback. Please visit [www.taxjustice.net](http://www.taxjustice.net) for more information.

TJN has published three reports on the CRS so far:

1. analysing the first publication of the CRS ([here](#)),
2. a [report](#) based on a survey among developing and developed countries regarding AEOI
3. a [technical report](#) explaining the scope of the CRS as well as analysing many of its – still unresolved – loopholes.

TJN has also published blogs articles (e.g. [here](#), [here](#) and [here](#)) analysing loopholes and other obstacles, notably [problems with the United States](#).

Our analysis of the latest package follows.

### **Box: Automatic Exchange of Information (AEOI)**

From 2017, many countries will start exchanging information with each other about financial accounts (i.e. bank accounts, interests in mutual funds or other investing entities, etc.) held in their financial institutions by non-residents. This will allow participating countries to find out about their residents' undeclared accounts held abroad, as a way to fight tax evasion. The main breakthrough is that this exchange of information will take place automatically, and regarding all of a country's residents. By contrast, the previous standard mechanisms were mostly used to merely 'confirm' investigations: they depended on specific requests about specific taxpayers, and only if the requesting country had enough data on them (i.e. their bank account held abroad).

## 2. The new package

### Overview

In August 2015 the OECD published three new documents: first, a [Handbook for Implementation of the CRS](#), the subject of today's report; second, a [Model Protocol to the Tax Information Exchange Agreements](#) (TIEAs); and third, an Update on [Offshore Voluntary Disclosure Programs](#).

Before analysing the handbook, however, we will make some brief observations about the other two documents.

The **Model Protocol for TIEAs** is worrisome, because it suggests that many countries are keen to opt out of the multilateral framework (the MCAA mentioned above), and have expressed an interest instead in signing (or amending) bilateral treaties as their way of implementing AEOI. The multilateral approach saves time and resources for everyone, especially developing countries.

The report on **Offshore Voluntary Disclosure Programs** surveys voluntary disclosure programs available in 47 countries, in addition to providing guidance on how to implement and design these programs – since many jurisdictions will likely offer these programs to their non-compliant residents before AEOI starts to take place. We will not analyse the programs or the guidelines here but their existence highlights the hypocrisy of most tax havens<sup>1</sup>: they typically prevent their own residents from evading taxes (with hefty fines and prison punishments) while being more than open to receiving illicit financial funds from foreigners, which may have originated in tax evasion, money laundering or corruption. Several of these jurisdictions -- notably the U.S. -- will not even implement the CRS, allowing all these funds deposited and invested in their financial centres to keep evading taxes at home.

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<sup>1</sup> We prefer the term 'secrecy jurisdiction', since the most striking feature of tax havens is not necessarily their nil tax rate, but their opacity. The [Financial Secrecy Index](#) explains this in more detail.

## 2.1 The CRS Implementation Handbook

The Handbook provides some clarifications, especially regarding the comparisons and consistency between the CRS and U.S.'s FATCA, and publishing answers to questions asked by relevant parties (notably, from the financial industry). While the document has some positive aspects, the OECD has not closed or addressed many of the CRS loopholes already identified by TJN<sup>2</sup>.

Here are our preliminary observations about the Handbook, in several sections.

2.1.1 Positive aspects: what has improved since our last report.

2.1.2 Major negatives: what has not been fixed or addressed. A much longer section.

2.1.3 Detailed negatives: for connoisseurs of technical detail

2.1.4 A special focus on trusts

2.1.5 Loophole USA: the problem with the United States

### 2.1.1 What has improved?

- **TIN Validation.** There is still no requirement for all jurisdictions to issue Taxpayer Identification Numbers (TINs)<sup>3</sup> or for all financial institutions (FIs) to collect them. However, for cases when FIs do collect and report TINs, the OECD expects jurisdictions to provide information regarding its TIN structure and specification (i.e. it is a 9-cipher number) so that FIs may validate them to increase accuracy.
- **Low-risk accounts and FIs.** Jurisdictions will have to publish the list of FIs and accounts which are considered of low-risk and thus excluded from reporting. At least civil society organizations will be able to scrutinise this. Additionally, the Handbook reiterates that certain FIs that would be considered non-reporting FIs because of their status (i.e. Government entity,

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<sup>2</sup> See [here](#) (pages 29-47).

<sup>3</sup> TINs are very important because they allow information to be matched. The whole purpose of AEOI is for authorities to receive information about accounts held abroad and then compare this data with local tax returns (filed by residents) to detect cases of undeclared accounts or tax evasion. Since names, addresses and other identification data could be spelled in many different ways, a number-ID allows the matching process to be done automatically and more efficiently.

International Organization or Central Bank) would still have to report on payments which are related to commercial financial activities, for example if they acted more like a Custodial or Depositary bank. This would prevent Central Banks or other Government entities in tax havens from assisting commercial banks which attempt to hide (not report) some account holders by transferring their accounts to the Central Bank or Government entity.

- **Collecting data on all account holders.** The OECD (invoking the interest of FIs) recommends that jurisdictions start collecting and reporting information about all account holders, regardless if they are resident in a reportable jurisdiction (a jurisdiction participating in the CRS) or not. They also suggest different steps to do this (collect information about all account holders regardless of their residence, or at least about all residents of jurisdictions which signed the MCAA or committed to the CRS, even if they are not implementing it yet). This is an improvement since the July 2014 publication (where this option was merely in an Annex). However, collecting information about all account holders (especially those resident in non-participating jurisdictions, notably developing countries), could be extremely relevant to tackle illicit financial flows (as will be explained below). So **this provision to broaden collection should have been a rule for all jurisdictions, or at least the default option.** It should have also included the requirement that FIs submit all this data to their authorities as soon as possible, so that these may start compiling and sorting the received information to create and publish the AEOI Statistics we refer to below.
- **Broad definition of 'gross amounts' against insurance loophole:** the insurance industry has attempted to exploit loopholes<sup>4</sup> involving the definition of 'cash value insurance contracts' to offer insurance products which fell outside the scope of the CRS. Maybe as a result of that, when the Handbook describes the information that has to be reported on some accounts (the 'gross amount' paid or credited to the account holder) it reiterates that 'gross amount' includes any redemption payments made (in whole or part) to the account holder; and any payments made under a Cash Value Insurance Contract or an Annuity Contract **even if such payments are not considered Cash Value.**

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[http://www.economist.com/news/finance-and-economics/21645259-making-tax-transparency-standards-watertight-will-be-difficult-leaks-tap;](http://www.economist.com/news/finance-and-economics/21645259-making-tax-transparency-standards-watertight-will-be-difficult-leaks-tap)

## 2.1.2 What has not been fixed – or addressed – since TJN’s last technical report

### Overview

In November 2014 TJN published a [technical report](#) identifying several loopholes that would affect the effectiveness and inclusion of developing countries in AEOI under the CRS.

For example, our criticism against the limited scope of the CRS, which **excludes from its coverage ownership of real estate<sup>5</sup>, safe deposit boxes and art, gold or other hard assets held in freeports.**

Moreover, the **threshold for the definition of “controlling person”** (that triggers the identification of the real individual owning or controlling an entity that holds an account) **is too high (above 25% of ownership) and only applies to some types of entities<sup>6</sup>.**

Another issue is the **lack of sanctions<sup>7</sup>** in case a tax haven decides not to participate or comply with the CRS, and the limitation to use the received information only for tax purposes, and thus **excluding its use (and sharing) with law enforcement authorities which deal with corruption and money laundering.** The same applies to obstacles identified in the MCAA (such as **the ‘dating system’ to cherry pick jurisdictions with whom to exchange information**), because these issues are beyond the CRS itself.

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<sup>5</sup> Unlike FATCA, which included at least non-debt direct investments in real property within the definition of financial asset (and investment entities investing or trading directly in real estate would have been needed to report on their account holders). In addition, the revised EU Directive on Administrative Cooperation (DAC) also contemplates exchanging information about ownership and income from real estate property if the information is available to Competent Authorities.

<sup>6</sup> Identification of “controlling persons” (equivalent to FATF’s “beneficial owner”) only applies to entities considered “passive” (because most of their income is passive, such as from interests or dividends), but not to those entities considered “active” (income from active business operations). See box on trusts below for more details.

<sup>7</sup> There is still no recommendation for collective sanctions in case a jurisdiction refuses to send information or otherwise fails to comply with the CRS. The only consequence would be either to stop AEOI (this would help if both jurisdictions genuinely need the information, but a non-complying tax haven would not care much if it no longer receives information from, say, a developing country (rich Nigerians may stash their money in Switzerland, but few Swiss tax evaders will choose Nigeria to stash theirs). Another possible consequence is a negative peer review by the Global Forum. However, politics and timing (peer reviews based on the CRS may not start for at least two years) do not make this truly effective. Some tax havens will thumb their nose at the OECD, and aggressively attract large new illicit inflows. It is notable that the Handbook describes how the CRS was based on the U.S.’ FATCA programme to ensure consistency -- yet the OECD omitted FATCA’s most salient feature: a 30% withholding tax in case of non-compliance.

It is understandable that some of those loopholes are not addressed by the Handbook (which deals with how to implement the CRS, but not with how to change it).

However, other very relevant loopholes could have been improved or at least referred to in the Handbook. In particular:

- **Sham changes of residency.** The CRS is based on determining the residence of each account holder so that the account information will be sent to their corresponding country. However, any account holder could simply avoid reporting (to its real country of residency) by pretending to be a resident of a tax haven<sup>8</sup> which sells residency certificates in exchange for money (so no one really needs to go anywhere, it is only a matter of papers). (In short, if the CRS generates financial information about a wealthy individual, that information will be transmitted to the sham jurisdiction – a tax haven – which will then studiously ignore the information. The taxpayer's genuine residence location stays in the dark). Many [tax havens already issue a certificate of residence in exchange for money](#). It would be relatively easy to stop this: create a blacklist of "residence-for-sale" jurisdictions, and for anyone claiming residence of these places, their previous residence should be provided. In addition, when determining the 'reasonableness' of the residence declared by an account holder (in the self-certification), FIs should pay attention to cases where the place of birth does not match the current residence. Related to this, the Handbook explains that it **is optional – although not a requirement under the CRS – to ask account holders** (when they provide a self-certification to prove whether they are resident or not in a participating jurisdiction) **that they also update the FI of any changes that would affect their status** (for example, if they become reportable persons). In other words, if an account holder somehow proved with a self-certification not to be a reportable person but then becomes one, it appears that he would not need to inform the FI. It is up to the FI to find out about these changes of circumstances. This is an important potential loophole, which ought to be closed by requiring account holders to update any changes that affect their status as reportable persons or as resident in a different jurisdiction. Moreover, the Handbook should clarify that **FIs should also check local account holders, meaning those who are resident in the same jurisdiction as the FI to identify avoidance schemes**. These local account holders would not be 'reportable persons' (since they are resident in the same jurisdiction as the FI their information would not need to be sent to any other jurisdiction). However, they are still relevant for two

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<sup>8</sup> Paraguay is a new example of this: <http://www.qwealthreport.com/permanent-residency-what-is-it-good-for/>; 26.8.2015.

reasons. First, because if these local account holders are “Passive NFEs<sup>9</sup>”, FIs will need to look-through them to identify the individuals controlling them (called ‘controlling persons’) and report those controlling persons who are resident in a jurisdiction participating in the CRS. Second, this should also apply to individuals who may have acquired a ‘sham residency certificate’ as a way to avoid reporting. In other words, consider two cases. First, a German individual controlling a company incorporated in Gibraltar that has only passive income (a Passive NFE), and where this Gibraltar company has a bank account in Gibraltar. While the Gibraltar bank would not need to report –for CRS purposes - on the Gibraltar company itself (because it is a local), it would still need to look-through it to identify the German individual controlling the Gibraltar company and report his information to Germany (via Gibraltar authorities). Under the current rules, it is not clear enough that FIs need to check their local companies (even if not reportable themselves) to identify those individuals who control these entities (who may indeed be reportable). The second case refers to local individuals. Another German resident with a bank account in a Gibraltar bank could have acquired a residency certificate from Gibraltar in exchange for money, while still living and working in Germany. This way, he would attempt to pass as a local to prevent his information from being sent to Germany. In principle, the Gibraltar bank would not need to report (or check) on locals (on Gibraltar residents). However, as expressed earlier, FIs should make sure that individuals are not presenting sham residency certificates. Therefore, the Gibraltar bank should still look at local account holders to check if they are really resident there or not. In our case, the Gibraltar bank would check the account holder presenting a Gibraltar residency certificate but ask for nationality, place of birth and other past residences. This way it could conclude that the account holder is actually a German resident, and thus send his information to Germany, neutralizing the avoidance scheme. In other words, FIs should always check their local entities (if they are considered Passive NFEs) to check whether any individual controlling them is resident in a participating jurisdiction and in such case, report those individuals. At the same time, FIs should also check their local individuals to make sure that they are not using sham residency certificates to avoid being reported.

- **The US\$ 250,000 threshold for pre-existing accounts held by entities, plus allowing new accounts by existing account holders to be classified as ‘pre-existing accounts.’** The CRS differentiates –among

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<sup>9</sup> See below for explanation of ‘Passive NFEs’, which basically means entities whose income is mostly “passive” (from dividends, interests, etc.).

other - between accounts opened after a cutoff date ('new accounts') and those that were already existing by then ('pre-existing accounts'). Notwithstanding the difference in terms of the due diligence to be performed by FIs (less demanding for pre-existing accounts), there is a US\$ 250,000 threshold for 'pre-existing' accounts held by entities (i.e. a company, a trust, etc.), below which there is no need to report the account, unless the jurisdiction decides otherwise. As we have explained in our technical report, this is a major loophole because any person (or entity) could avoid reporting (regardless of how much money they have) by creating entities (shell companies, trusts, etc.) to hold different accounts and then divide all the money among these accounts.

Our concern is that it is up to each jurisdiction to keep this US\$ 250,000 threshold or not (it should not be an option, let alone the default rule). The second problem is that the cutoff date to consider an account as 'new' or 'pre-existing' is too late in the future (December 31<sup>st</sup>, 2015) for the first countries that will start exchanging information in 2017 (called 'Early adopters') and even later for all other countries. This will give plenty of time to anyone to arrange their affairs. On top of everything, countries may choose<sup>10</sup> to treat 'new accounts' (opened after the cutoff date) as 'pre-existing,' benefitting -among other - from the US\$ 250,000 threshold, as long as the account holder already had an account and no new information is required to open the new account.

- **Pre-AML/KYC<sup>11</sup>:** Jurisdictions and FIs should only be allowed to use information obtained pursuant to AML/KYC when they can prove that they complied with 2012 FATF Recommendations. Otherwise, FIs would be using data which could either not be trustworthy (if not AML was performed at all) or at least not sufficient (i.e. FATF Recommendations prior to 2012 did not require the identification of the settlor of a trust in all cases as the beneficial owner). Instead, and based on the fact that it is 'rare in practice', the OECD allows that:

*where accounts were opened prior to AML/KYC requirements being in place and Documentary Evidence has not been obtained at the time of or since the opening of the account, provided the Financial Institution's policies and procedures provide sufficient comfort that the address on*

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<sup>10</sup> The OECD claims that the rationale behind this is that if new information has to be sought, then the account holder could just as well provide the self-certification needed for new accounts. However, the same could be said in case the account holder communicates with the FI to open a new account. Once that happens, the FI could ask for a self-certification.

<sup>11</sup> AML = Anti Money Laundering; KYC = Know Your Customer (due diligence checking)

*file is current, as set out in the Standard, then the Documentary Evidence condition can still be satisfied*<sup>12</sup>.

In other words, even if the FI performed no AML/KYC nor has any documentary evidence (i.e. a government-issue certificate) to prove the account holder's residence, the FI could simply use whatever address it has on records.

If this was not yet soft touch enough, look at this answer regarding an account held by an entity (i.e. trust) with a value below US\$ 1,000,000, where only the name of the controlling person (i.e. a beneficiary) was identified (but not their residence) because the FI was not required to collect such information pursuant to applicable AML/KYC procedures:

*Since, in the example given, the Financial Institution does not have and is not required to have any such information on file that indicates the Controlling Person may be a Reportable Person, it cannot document the residence of the Controlling Persons and does not need to report that person as a Controlling Person*<sup>13</sup>

In other words, in certain cases, if the FI cannot determine the residence of the controlling person, there is no requirement to 'obtain it one way or another, or otherwise close the account', but simply not to report it, benefitting those who did not provide enough information in the first place.

While not explicitly mentioned, it appears that the same ridiculous result would apply in case a FI was not required to identify for example the settlor, under applicable AML/KYC. In this case, the FI would not know the name (let alone the address) of the settlor, although it would know that they exist (all trusts must have a settlor). Still, it would appear that in this case the FI would not need to require identification of the settlor either, benefitting again those who submitted less information.

- **Account Balance, or Average?** Instead of suggesting the reporting of both the account balance (on X date) and the account's annual average balance, the OECD allows jurisdictions to choose between the two, although the account balance is the default rule. However, it is harder to circumvent the annual average rule, because the "balance" option merely provides a snapshot taken on a specific date, regardless of how much money was in the account the day before or the day after. It is easy to shift money in and out before and after the relevant date. Some jurisdictions are allowed to

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<sup>12</sup> Handbook, page 53.

<sup>13</sup> Handbook, page 104.

calculate the average on the highest value of each month. This should be the default.

**Closure of Accounts.** In contrast to FATCA regulations - which served as the basis for the CRS - the latter does not require that, in case of closure of accounts (say, if any account holder is withdrawing all the money to avoid reporting) the account balance has to be reported, but only the fact that the account was closed. The average balance in the year of closure should be reported. However the balance should be calculated on the average highest value of any month. This is to prevent the use of large short-term transaction through the account.

- **Irrevocable Insurance products to avoid reporting.** The Economist<sup>14</sup> referred to these avoidance schemes involving new insurance products that are "irrevocable" in order to fall outside the definition of the CRS' "Cash Value Insurance Contracts" (and thus avoid reporting). One could argue that some of these irrevocable insurance products would still be within the scope of the CRS if they are "life investment-linked policies"<sup>15</sup>. In addition, anti-avoidance provisions in each jurisdiction should prevent these schemes from circumventing the CRS. However, the Economist article proves that the insurance industry was already coming up with these new products as a result of the CRS. Therefore, the Handbook could have at least clarified (and warned the financial industry as well as authorities) that these new insurance products are also within the scope of the CRS.
- **Unlimited retirement funds**<sup>16</sup>. "Narrow Participation Retirement Funds" (i.e. retirement funds for current or former employees) that meet certain conditions may be considered non-reporting FIs - so they would not need to report their account holders - because they are supposed to present low risk for tax evasion. These "liberating" conditions include, among other, that (i) either contributions to the fund are limited by reference to the earned income and compensation of the employee (as originally prescribed by the CRS<sup>17</sup>), or (ii) **contributions by the employer or employee may be unlimited**<sup>18</sup>,

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<sup>14</sup><http://www.economist.com/news/finance-and-economics/21645259-making-tax-transparency-standards-watertight-will-be-difficult-leaks-tap>; 25.8.2015

<sup>15</sup> <http://www.the-best-of-both-worlds.com/support-files/irrevocable-insurance-legal-brief-v1.3.pdf>; 26.8.2015.

<sup>16</sup> <http://www.the-best-of-both-worlds.com/>; 26.8.2015

<sup>17</sup> CRS, Section VIII, B.6.c

<sup>18</sup> Notwithstanding a retirement fund's status as a reporting FI, an account with such retirement fund could still be considered an "excluded account" (and thus not be reported), if contributions to such account were limited to US\$ 50.000 per year or there was a maximum lifetime contribution limit of US\$ 1.000.000. However, in the present case, since

but the tax relief associated to the contributions is limited to the earned income and compensation<sup>19</sup>. This means that a person could set up an entity in a tax haven, pretend that such an entity is its employer, create a retirement fund and contribute as much money as desired. Apparently, as long as the tax relief is limited to the income or compensation (even if there is no income tax in such tax haven), such retirement fund would be considered excluded from reporting obligations. While one could argue that anti-circumvention provisions to be established by each jurisdiction should prevent a scheme like this from taking place, the Handbook could have at least clarified (and warned the financial industry as well as authorities) about these strategies with pensions and retirement funds. One way to prevent this, is by publishing a list of all these excluded retirement funds, once authorities obtain their 'nil returns' indicating that they do not have reportable accounts (see below for more details on nil returns).

- **Effective Implementation.** The OECD offers little guidance on domestic regulation to ensure compliance with the CRS by FIs, unlike the detailed questionnaire that jurisdictions will have to answer (and comply with) to ensure confidentiality of the received information. For example, the Commentaries to the CRS suggest that jurisdictions impose anti-avoidance rules against FIs advising a customer to shift an account to a Related Entity in a non-participating jurisdiction (who could then avoid reporting). However, anti-circumvention measures should also cover shifting of accounts or customers to non-related entities<sup>20</sup>. In addition, the Handbook reminds jurisdictions that they may demand more confidentiality and data protection requirements over and above those of the questionnaire, by simply including any additional requirement in one of the Annexes of the MCAA that they must submit to the Secretariat, after having signed the MCAA to engage in AEOI.
- **Filing of nil returns by FIs.** If an FI (i.e. a bank) does not have any account that needs to be reported to authorities, then it could simply do nothing or instead, it could be required to file a 'nil return' (to indicate that it has no reportable accounts). Filing a nil return seems a better option, to ensure that all FIs are aware of their obligations - and also to hold them

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the retirement fund itself is a non-reporting FI, contributions may be unlimited (more than US\$ 1.000.000 or more than US\$ 50.000 per year), as long as some conditions are met.

<sup>19</sup> Standard (with Commentaries to the CRS), page 172, available [here](#).

<sup>20</sup> The CRS defines 'related entities' according to majority of ownership or voting rights (see below for more details), but FIs could establish commercial relationships to help customers avoid reporting using non-related entities as well. This shows how little detail is available to establish anti-avoidance rules.

accountable in case of misreporting. Therefore, this should have been the rule or the default option.

- **Reduce cases of Active NFEs.** Entity account holders may be considered 'Active' or 'Passive' Non-Financial Entities (NFEs) depending on their income and assets<sup>21</sup>. The key consequence of being a Passive NFE is that its 'controlling persons'<sup>22</sup> would have to be identified and reported, whereas Active NFEs do not need to identify or report any controlling person. The CRS classifies some entities as Active NFEs, regardless of the income or assets that would turn them into Passive NFEs. For example, non-profit entities, liquidating entities and 'start-ups'<sup>23</sup> are all considered Active NFEs. In other words, any individual trying to avoid being identified could simply create an entity to hold his account. Even if the entity is investing capital and earning only interest or dividends, it would be considered an Active NFE (not subject to identify any controlling person) as long as the entity is not yet running a business. This benefit for "start-ups" goes up to two years since the entity first organized itself.

### 2.1.3 Detailed commentaries

This section goes into greater technical detail and is aimed at experts.

- **Broaden the definition of 'managing' an investment entity.** An investment entity (i.e. a trust) will only be considered an FI if it is 'managed' by another FI (e.g. a bank). Both the Commentaries to the CRS and the Handbook describe that to 'manage' means to have 'discretionary authority' to manage the entity's assets. This could be easily avoided (and hence not become an FI which has to identify its equity and debt holders) by receiving 'non-binding' advice from the bank on how to manage the entity's assets. An easy solution to this avoidance strategy is to include 'non-binding' advice under the definition of 'management'.

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<sup>21</sup> If the income or assets could produce mostly 'passive' income such as dividends, interests, etc., it would be considered a Passive NFE.

<sup>22</sup> The natural persons owning or controlling an entity. The term is the equivalent of 'beneficial owner' under the definition of the Financial Action Task Force (FATF).

<sup>23</sup> An entity which, within 2 years, is not yet operating a business, but is investing capital into assets with the intent to operate a business.

- **Related entity.** Unlike FATCA which requires that an entity controls another entity (either via ownership or votes) to consider both entities as 'related entities', the CRS also<sup>24</sup> allows entities to be 'related' if they are both under common control. This means that under the CRS, it is easier to become a 'related entity'. This has opposing consequences regarding reporting and disclosure of information. On the one hand, reporting of information and more stringent due diligence rules depend on some value thresholds (i.e. US\$ 250.000 for pre-existing entity accounts, US\$ 1.000.000 for pre-existing individual accounts, etc.). To determine whether an account holder is beyond or below such threshold, all the accounts held by an individual or entity in an FI (and in its related entities) are aggregated. In this sense, the more 'related entities' available, the easier it should be to fall above the threshold to be subject to reporting and/or to be subject to more demanding due diligence provisions. However, this would only apply in case the FI's computerized system allows the linking of accounts. In contrast, 'related entities' are also involved in allowing that the less demanding provisions available for pre-existing accounts (those already existing as of a cutoff date) may be extended to new accounts (those opened after the cutoff date). As long as the individual or entity opening a 'new account' already had a (pre-existing) account in an FI or in the FI's 'related entities', the new account could be subject to the less-stringent provisions of pre-existing accounts (if no new information is required to open the new account). In addition, provisions for pre-existing accounts in certain cases<sup>25</sup>, involve no reporting whatsoever. Therefore, the more 'related entities' available, the easier it would be for an account holder opening a new account to have the FI treat this new account as if it were pre-existing for due diligence and reporting purposes. The same lack of reporting would happen in case of some non-reportable persons: corporations the stock of which is publicly traded are considered non-reportable (not subject to reporting). The same non-reporting status would be given to a corporation that is a 'related entity' of the former corporation. A first indirect solution to this last case would be to narrow the definition of related entity. An even better and more thorough solution would be to treat 'listed corporations' and their related entities as non-reportable only if they prove (not merely declare) to the FI that their ownership information (and that of their controlling persons) is already publicly available somewhere (for example in the webpage of the Securities Exchange Commission or similar institution).

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<sup>24</sup> Unlike FATCA, CRS's control involved majority of both ownership and voting rights.

<sup>25</sup> This would happen for example in case of pre-existing account held by an entity whose value does not exceed US\$ 250.000.

- **'Fake' telephone numbers to hide residency.** The CRS requires FIs to identify the residence of their accounts holders to determine whether they are reportable persons (because they are resident in a jurisdiction which participates in the CRS) and in such case to report their account information to their corresponding jurisdiction of residence. For pre-existing<sup>26</sup> accounts held by individuals, FIs may in some cases search their electronic records to look for indicia on the residence of the account holder. Among the indicia to be searched, finding a telephone number from a jurisdiction participating in the CRS would turn the account holder into a resident of that jurisdiction (for CRS purposes) and thus, a reportable person. However, the telephone indicia is nullified in case the account holder also has a telephone number in the jurisdiction of the FI. In other words, if a German bank (in Germany) finds that an account holder has a French telephone number associated to the bank account, it would assume that the account holder is a French resident and thus report his account information to France, unless the account holder also has a telephone number from Germany (the jurisdiction of the German FI). In this case, the telephone indicia would not be applicable. Regardless of the rationale of this, current internet options (such as skype numbers<sup>27</sup>), allow anyone to buy a number and choose the country and area code, making it very easy to 'nullify' the telephone indicia (by choosing the country code of the FI), to prevent being identified as a resident of a specific jurisdiction.

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<sup>26</sup> Those already existing as of a cutoff date.

<sup>27</sup> <https://support.skype.com/en/fag/FA331/what-is-a-skype-number>; 9.9.2015

## 2.1.4 Trusts: specific loopholes

Trusts are very complex structures<sup>28</sup> which pose serious risks for tax evasion and money laundering (see [here](#)), especially for their opacity and lack of registration. Regardless if the trust is considered a mere legal arrangement (a contract) or a legal person according to the laws that govern it, the CRS classifies trusts as entities.

Trusts' possible sub-classification<sup>29</sup>: FI-Trust, Passive-NFE-Trust or Active-NFE-Trust

<b>Condition</b>	<b>Sub-classification</b>	<b>Requirement to Report about...</b>	<b>Related Parties to be reported</b>	<b>Exception (other than not being resident in a participating jurisdiction)</b>
Trust is an investment entity and is 'managed' by another investment entity (e.g. a bank)	<b>FI-Trust</b>	"Debt Holders" (as defined by local jurisdiction) and "Equity Holders"	<u>Equity Holders:</u> settlor, mandatory beneficiary, discretionary beneficiary that received a distribution, and any other person with effective control over the trust	1) It is a specific cases of a "non-reporting financial institution", such as a broad or narrow participation retirement fund. 2) Its trustee is an FI that will report all the trust information (this would avoid duplication)
Trust holds an account with an FI (i.e. a bank account), and most of its	<b>Passive NFE-Trust</b>	1) The trust as an NFE, and 2) its Controlling Persons	<u>Controlling Persons:</u> settlor(s), the trustee(s), the protector(s) (if	Any case of specific Active NFE (start-up, liquidating entity, etc.)

<sup>28</sup> Basically, trusts allow separation of assets once the 'settlor' delivers assets for a 'trustee' to administer in benefit of beneficiaries, who may have been predetermined or who could be chosen by the trustee at its own discretion (thus called 'discretionary beneficiaries').

<sup>29</sup> This table does not include trusts which would not be covered by the CRS, for example because they have no financial assets (e.g. no bank account, but only own real estate).

income/assets could produce passive income			any), the beneficiary(ies) or class(es) of beneficiaries, and any other natural person(s) exercising ultimate effective control over the trust	
Trading Trust carrying on business activities (so no passive income/assets) or charity trust	<b>Active-NFE trust</b>	The trust as an NFE (no identification or reporting of its controlling persons)	None	

The CRS requires different reporting of information depending on the trust sub-classification. A trust may be considered an FI ('FI-Trust') if (i) it is an investment entity (earns most of its income from investing or trading financial assets such as stocks, futures, etc.) and (ii) if it is "managed"<sup>30</sup> by another FI (such as a bank). There is an exception however, if the trust - that would otherwise be an FI-Trust for meeting both conditions - falls within any of the cases of "Non-Reporting FIs" established by the CRS, such as being a broad or narrow retirement fund. Another case that would prevent a trust from being an FI-Trust is in case of duplication of information: if the trust's trustee is itself a reporting FI (that will already have to report the trust's information). FI-trusts need to report account holders who have an Equity or Debt Interest in the trust. Equity is considered to be held by the settlor, (mandatory) beneficiaries, discretionary beneficiaries who received a distribution in the calendar year, and any other person with effective control over the trust.

If it is not an FI, a trust may simply be an account holder (for example if it holds a bank account) and it will not be a FI but rather be classified as a Non-Financial Entity, ("NFE"). The trust may be considered a Passive NFE (if its assets and income are mostly passive, such as from interests, dividends, realized capital gains on equities, rent from non-core business activities, etc.) or an Active NFE (i.e. a charity trust or a trust that engages in business operations as if it were a commercial company). Trusts which are considered Passive NFEs are subject to 'look-through' (FIs need to look-through the trust to identify its controlling persons: settlors, trustees, beneficiaries, protectors, or any other person who actively

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<sup>30</sup> See above for definition of 'management'.

controls the entity) Trusts which are Active NFE are only reported at the trust level without identifying anyone related party.

While many loopholes may affect trusts (i.e. those related to pre AML/KYC requirements mentioned above), there are provisions that refer specifically to trusts:

**Residency.** Trusts are considered 'resident' wherever one of its trustees is resident. This seems problematic considering that a person could create a trust in any jurisdiction participating in the CRS, but still appoint trustees who are resident in non-participating jurisdictions (such as in the U.S. or Panama), the result of which would be that the trust itself would not be a reportable person and its account information will not be reported<sup>31</sup>. Therefore, in addition to the trustee residence rule, trusts should also be considered resident in the jurisdiction under which laws the trust is governed. In this case, the trust's account information should be reported to as many jurisdictions as residences the trust has - this is the rule when an FI cannot determine the residence of an account holder among many; it then has to report the account to all the identified jurisdictions.

**No reporting if no-residence for tax purposes.** An entity which has 'no residence for tax purposes' (either because it is fiscally transparent or because it is located in a jurisdiction without income tax) could be considered resident either in the place of incorporation or in the place of effective management. However, this does not apply to trusts, which would avoid reporting altogether as long as they have no residence for tax purposes. Even the Handbook notes that "in many cases a trust has no residence for tax purposes. In that case the trust is not considered to be a Reportable Person"<sup>32</sup>. As expressed above, trusts should be considered resident at least in the jurisdiction under which laws the trust is governed.

**Narrow choice for discretionary beneficiaries:** while FI-trusts need only report discretionary beneficiaries when they received a distribution from the trust, Passive-NFE-trusts should always report all their controlling persons (including discretionary beneficiaries). The Handbook allows jurisdiction to treat discretionary beneficiaries of Passive-NFE-trusts as FI-trusts, requiring reporting only when a distribution takes place. However, the opposite should happen: even FI-trusts should report discretionary beneficiaries regardless of any distribution taking place. At least, this should be the default option. In other words, instead of having the option to apply provisions of FI-Trusts to Passive-NFE-Trusts, the default option (or the obligatory rule) should be to apply Passive-NFE-Trusts' provisions to FI-Trusts. This would broaden reporting for discretionary beneficiaries, and also for 'protectors' which are explicitly considered controlling persons of Passive-NFE-Trusts, but who are not mentioned among the "equity holders" of FI-Trusts.

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<sup>31</sup> As explained above, this would happen if the trust is an Active NFE. If the trust is a Passive NFE, there will be no reporting at the trust level, but its controlling persons (settlor, trustee, etc.) will still need to be identified.

<sup>32</sup> Handbook, page 83.

**Reporting of all controlling persons to all relevant jurisdictions.** While it may not make sense to demand reporting of all the controlling persons of a company to jurisdictions where they are not resident, the same should not necessarily apply to trusts. These are many times used within families as asset protection and tax planning, so authorities could find it very useful to know the identity of all related persons of the trust (i.e. the settlor, trustee and beneficiary) even if not all of them are resident there. It would enlighten about avoidance schemes using sham residency certificates or at least to know which tax havens and service providers (trustees) are chosen by wealthy individuals. However, the Handbook explains that only controlling persons of a trust which are reportable persons (i.e. individuals resident in a participating jurisdiction) will be identified and reported to their specific jurisdiction of residence. The OECD should prescribe, at least as an option, that all the controlling persons of a trust be identified and reported (together), regardless of their residency.

**Not reporting of some controlling persons.** Controlling persons (of a Passive-NFE-trust) who are resident in the same jurisdiction as the reporting FI (i.e. the bank where the trust has an account) would not be reportable persons (their information will not be reported), unless the jurisdiction chooses to. Instead, and given the lack of effective trust registration in most jurisdictions, controlling persons should always – by default – be considered reportable, even if they are resident in the same jurisdiction as the FI where the trust holds an account. Otherwise, jurisdictions may never find out about those controlling persons.

**Type of each controlling person:** the Handbook explains that where FIs have information as to what type of controlling person each one is ('settlor', 'trustee', 'beneficiary', etc), this should also be reported. Again, this should be the default rule or even a prescribed requirement, especially for those jurisdictions which are not yet subject to 2012 FATF Recommendations and thus may not have this information available.

#### 2.1.5 Loophole USA: The case of the United States

An important question is whether the U.S. will be considered a non-participating jurisdiction. This should definitely be the case (since the U.S. will not implement the CRS but only FATCA<sup>33</sup>). In such case, the CRS' 'Passive-NFE anti-avoidance provision for investment entities<sup>34</sup>' should apply: some investment entities (i.e.

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<sup>33</sup> <http://www.oecd.org/tax/transparency/AEOI-commitments.pdf>; 26.8.2015

<sup>34</sup> The CRS has this anti-avoidance provision. In principle, FIs are not reportable persons (an FI need not report an account held by another FI) because the latter would still need to report information about its account holders. However, if a FI-trust (i.e. a trust that is an investment entity managed by a bank) holds an account in an FI but the trust is not resident in a participating jurisdiction, then the trust would not need to report any accounts, but would still not be reportable by the FI where it holds the account. To prevent this, the CRS requires the FI that holds the trust's account to consider such trust as a Passive NFE and thus to identify its controlling persons.

some trusts) which are resident in the U.S. - that would otherwise be considered FIs - should be regarded as Passive NFEs and hence be subject to look-through to identify their ultimate controlling persons (settlor, trustee, beneficiary, etc). (If this were not the case, these investment entities would be considered 'FIs' and thus would not be subject to reporting.)

## 2.2 Missed opportunities: AEOI Statistics and Spontaneous Exchange of Information

Alongside the gaps and shortcomings in the OECD's package, there are some issues that aren't apparently even on the OECD's radar screen.

Once FIs collect all the information about their corresponding account holders, they will send this data to their own authorities, who will have to process it for onward transmission (to the corresponding jurisdictions where account holders are resident). This will involve compiling all the information received from FIs and then sorting it by jurisdiction.

As explained above, the OECD suggests that jurisdictions could choose<sup>35</sup> to collect information not only about account holders who are resident in jurisdictions participating in the CRS but also about residents of any other jurisdiction, or at least of those who are resident in jurisdictions which committed to the CRS or that have signed the MCAA. The Handbook explains that FIs could collect all this information and have it ready to be sent to their own authorities (for when those jurisdictions start participating in the CRS). A better option offered by the Handbook is that FIs do not wait but that they send all this information to their own tax authorities as soon as possible. Although authorities will not be able to exchange this information with jurisdictions which are not yet participating in the CRS, they could at least start processing it and compiling it as they will do with the rest of the data.

Once authorities have processed information about all account holders (both reportable ones and those who are resident in jurisdictions which are not yet participating in the CRS), authorities could publish AEOI Statistics<sup>36</sup>, indicating the total amount of funds held in their FIs by non-residents, detailing for example the average account value by country of origin, differentiating between accounts held by individuals or by entities, and disclosing the number and type of accounts (deposit accounts, custodial accounts, etc.). Since this would be published in an aggregate basis, specifying only the jurisdiction of residence, no confidentiality would be compromised (no single person or entity would be identified). This would be extremely valuable for jurisdictions which cannot yet participate in the CRS –

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<sup>35</sup> As explained, we believe that this should be the rule, or at least the default option.

<sup>36</sup> TJN has drafted a template of AEOI Statistics which has been shared with the OECD.

notably, developing countries – who would still be able to find out how much money is held abroad and undeclared. This would work as a great incentive for developing countries to undertake the necessary changes to be able to participate in the CRS. Furthermore, these statistics can act as an important tool to evaluate overall effectiveness and compliance with CRS.

Moreover and in parallel, the Handbook should have recommended at least, that authorities of developed countries and financial centres also exchanged information spontaneously with authorities from developing countries, for example about high value accounts.

### 3. Conclusion

The Handbook is intended to explain and clarify the CRS (as was originally designed) for authorities and FIs that will be participating in the CRS and FATCA. Unfortunately, the OECD neither addressed many important loopholes (i.e. provisions regarding sham residence certificates), nor established the most encompassing options as the default rules (no US\$ 250,000 threshold for pre-existing entity accounts, average balance account, etc.).

Regarding developing countries, there are no provisions that could benefit them, such as TJN's proposal on AEOI Statistics or the suggestion to exchange information spontaneously. The OECD could have at least made a reference to the MCAA, recommending that all countries choose all other signatory countries, instead of applying the 'dating system' (that will very likely affect developing countries that did manage to sign the MCAA).