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FStaxworld
Your May snapshot

In this month's FS*taxworld*, we analyze key questions raised by the implementation of OECD CRS in the insurance industry.

The view from Deloitte

Dear Reader,

Like FATCA, the Organization for Economic Co-operation and Development (OECD) standard on financial account due diligence and reporting (altogether, commonly referred to as the Common Reporting Standard or CRS) is a regime designed predominantly with banks in mind. The insurance industry must again make the most of definitions and provisions that do not fit to the products and relationships in effect.

Although sometimes interpreted in news commentaries as an attempt to escape the onerous requirements of the regimes, the insurers' complaints are in fact an effort to understand how the implementation projects can be moulded to match the requirements of the regime, or vice versa.

The most interesting questions, many of which were already raised during FATCA implementation, arise upon consideration of the account holder definition combined with the prescribed due diligence requirements. These uncertainties carry through to the reporting obligations, once a reportable person is identified amongst the account holders. The entity and product classifications should, on the other hand, not cause significant difficulties, given the broad similarities to FATCA.

The joint account holder status of a policyholder and a beneficiary causes confusion from the outset, in deciding whether the persons should be subject to the due diligence procedures for preexisting or for new accounts. The status of the account as preexisting should not be impacted by the addition of an account holder, but the application of the preexisting procedures to a beneficiary also does not appear coherent. A mixed form of the due diligence procedures generally results.

The addition of an account holder is included as a change in circumstance and it might be inferred, therefore, that the policyholder's tax residence is put in doubt whenever a payment is made to a beneficiary. In addition, upon identification of indicia, the due diligence requirements could be read to imply that the tax residence statuses of all account holders are impacted. This hardly seems appropriate when the payment of an amount to a beneficiary is a common action under a life insurance policy and when one person's tax residence generally has no influence on that of another.

Although CRS requires that the necessary information from a new account holder is obtained upon account opening, there is no clear explanation of what should be done in case a beneficiary does not provide the requested self-certification at the time of a payment. In Switzerland refusing the payment is hardly a feasible option. Should the person be reported as undocumented? Or as a resident of all reportable jurisdictions, as would be analogous to the assumption of U.S. person status under FATCA? To ensure consistency, such questions would need to be answered by international industry groups.

In order to provide some semblance of equality with the banks, insurers are granted an extraordinary right of termination in the draft Swiss implementing legislation on automatic exchange of information (Swiss AEOI act) in case an account holder does not provide certain necessary information within 90 days of account opening. This right of termination would provide a solution for Switzerland, but it remains to be seen how other jurisdictions will approach this. Assuming that this is an acceptable interpretation of "upon account opening", it is not clear how this would work in practice, in particular since this is currently not provided for under FATCA.

It is clear that a beneficiary becomes an account holder at the time of a payment. What remains unclear is for what time period the person has this status. Only at the moment of payment? For the full year in which the payment is made? Or for the full remaining term of the policy? The first option could result in no reporting under CRS as generally only the status at the year-end is relevant. The second would ensure reporting, but this would include the full surrender value of the policy as the account balance and the reporting would fall away in the following year as though the person changed residence to a non-reportable jurisdiction. The last option could well result in complaints of excessive reporting from the beneficiary. Treatment of the payment as an account closed in the year would result in a reasonable reporting, being the amount paid together with a zero account balance. This does not align with the interpretation that no new account is created upon payment to a beneficiary; however, this is rather a question of terminology.

The preexisting account due diligence procedures can be particularly onerous for insurers, given the long policy terms and commonly missing data points on policyholders and beneficiaries. Many insurers have resigned themselves to the likelihood that the back book exemption for individual policies under FATCA will not be applicable under CRS. Although the provision is provided, it is becoming increasingly difficult to understand the situations under which it may be applied. At the same time this also puts the application under FATCA in doubt, given that the provision is the same under both regimes and Swiss laws on sale of policies within Switzerland to non-Swiss residents do not distinguish between U.S. residents and other non-Swiss residents.

Reporting is another area where the presence of multiple account holders causes uncertainty in a financial institution's (FI's) obligations. The explicit requirement to report the full account balance for all joint account holders does not take into consideration the structure of ownership of an insurance policy. A beneficiary receiving a payment upon request of a policyholder cannot be deemed to be holding the full surrender value of the policy. In the case of payments it is open to interpretation whether CRS requires reporting of all payments in the period with respect to all account holders, regardless of what each person actually receives.

While account holder identification and consequent reporting obligations present abundant interpretive challenges, the legal entity classification, on the other hand, provides only few surprises under CRS for the insurance industry, mainly limited to exceptional cases presented by certain non-life insurers that issue policies with a minimal redemption upon termination. In addition, the determination of controlling persons in case of passive non-financial foreign entity (NFFE) status may produce different results under the two regimes, given the slightly different definitions. The non-reporting FI categories relied upon by the insurance industry are generally those for the Swiss social security system, as listed in annex II of the FATCA intergovernmental agreement (IGA). Such categories should be those least contested by the OECD and other jurisdictions and it therefore seems safe to assume that such categories will survive into the final Swiss AEOI act.

The classification of products as financial accounts also relies on several familiar definitions. Cash value insurance contracts will be the key factor for determining the obligations of many insurers, as under FATCA. The threshold of USD 50,000 in the FATCA definition does not, however, exist under CRS. As with most of the stricter rules under CRS, this may cause a reconsideration of the application under FATCA in order to align the two projects.

The depository account definition under CRS follows that under FATCA and does not explicitly clarify whether capital redemption products (insurance class A6 according to annex 1 of the Swiss ordinance on the supervision of private insurance companies (AVO)) should be included as such. In any case, accounts holding advance premiums on which interest is paid should be included, regardless of the account value in comparison to an annual premium.

There is hope that some of these questions will be answered in the Swiss ordinance and guidance on AEOI, expected to be published later this year, and certain classifications of entities, accounts, and payments are likely to be specified by the Federal Council.

In the meantime the insurance industry must work with what is available and apply interpretations of such points until the final rules are clear. It would certainly be beneficial if uniform interpretations were applied across the industry.

Regards,

Sarah Thomas
With thanks to Dr. Peter Lang and the Kalaidos University of Applied Science

Report from the FATCA Frontlines: Emerging Alternatives to Discretionary Portfolio Management

Due in primary part to FATCA, many banks are re-evaluating and reconfiguring the conventional provision of discretionary portfolio management to account holders. The rationale emerges from the FATCA treatment of entity account holders that would otherwise qualify as passive non-financial foreign entities (NFFEs), but which are converted into financial institutions (FIs) as a result of the discretionary portfolio management agreement with the bank. Unfortunately, the standard is plain: Where another FI controls the investment decisions of an entity holding financial assets (irrespective of the percentage of the entity's total assets under such control), such entity qualifies as a so-called professionally managed investment entity type FI under FATCA and in all likelihood will remain so under OECD CRS. Where these entities are personal investment vehicles with no employees or third-party administration, the regulatory consequences from becoming an FI are solely the result of the bank's discretionary portfolio management and undesirable. Thus, banks wishing to continue asset management advisory services to such clientele without subjecting them to an FI conversion are evaluating adaptations of the service. Approaches under consideration include:

• A requirement that the account holder initiate any transaction, such that advice and execution are sufficiently segregated from one another;
• A tightening of the investment portfolio strategy options, such that the decision to select a specific type of investment portfolio strategy reduces or eliminates the professional management discretion of the bank under its portfolio management authority; and
• Deployment of funds with similar purposes and outcomes to discretionary portfolio management, but via a different structure that will not disturb a passive NFFE status.

Each of the above-listed options intends to distance the provision of asset management advisory services further from the concept of professional management under FATCA. Each bank will, however, need to assess the boundary between asset management advisory services that qualify as professional management and those that do not. Then, the bank will need to determine its own appetite for proximity to this professional management borderline when examining modifications to existing offerings.

For more information, please contact **Brandi Caruso** or **Paul Millen**.

Final 871(m) Regulations Subject to Indefinite Delay

According to information circulated by the U.S. Department of the Treasury, the anticipated final section 871(m) regulations will not be released imminently as expected and the activation deadline for the rules (or the full set of the rules in any case) will be delayed correspondingly. Section 871(m) deems certain dividend-equivalent payments that reference underlying U.S. securities to be U.S.-source payments, which accordingly are subject to potential withholding and reporting. The proposed Regulations, released in December 2013, addressed this complex area of finance by means of a demanding implementation standard, featuring, inter alia, the introduction of the delta concept for derivatives into tax rules and the imposition of combination rules with challenging implications. As such, the consultation period attracted pointed criticism and strenuous lobbying efforts. In spite of the recent further postponement, the IRS remains committed to a broader and more effective section 871(m) and we thus expect further information on this subject matter over the next few months.

For more information, please contact **Paul Millen** or **Kevin Radon**.

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Authors

Sarah Thomas
Senior Manager Tax

Send email

Paul Millen
FS*taxworld* Editor

Send email

Brandi Caruso
FATCA Leader Switzerland

Send email