DAC vs EUSD
Conceding the battle to win the war (against tax evasion)?

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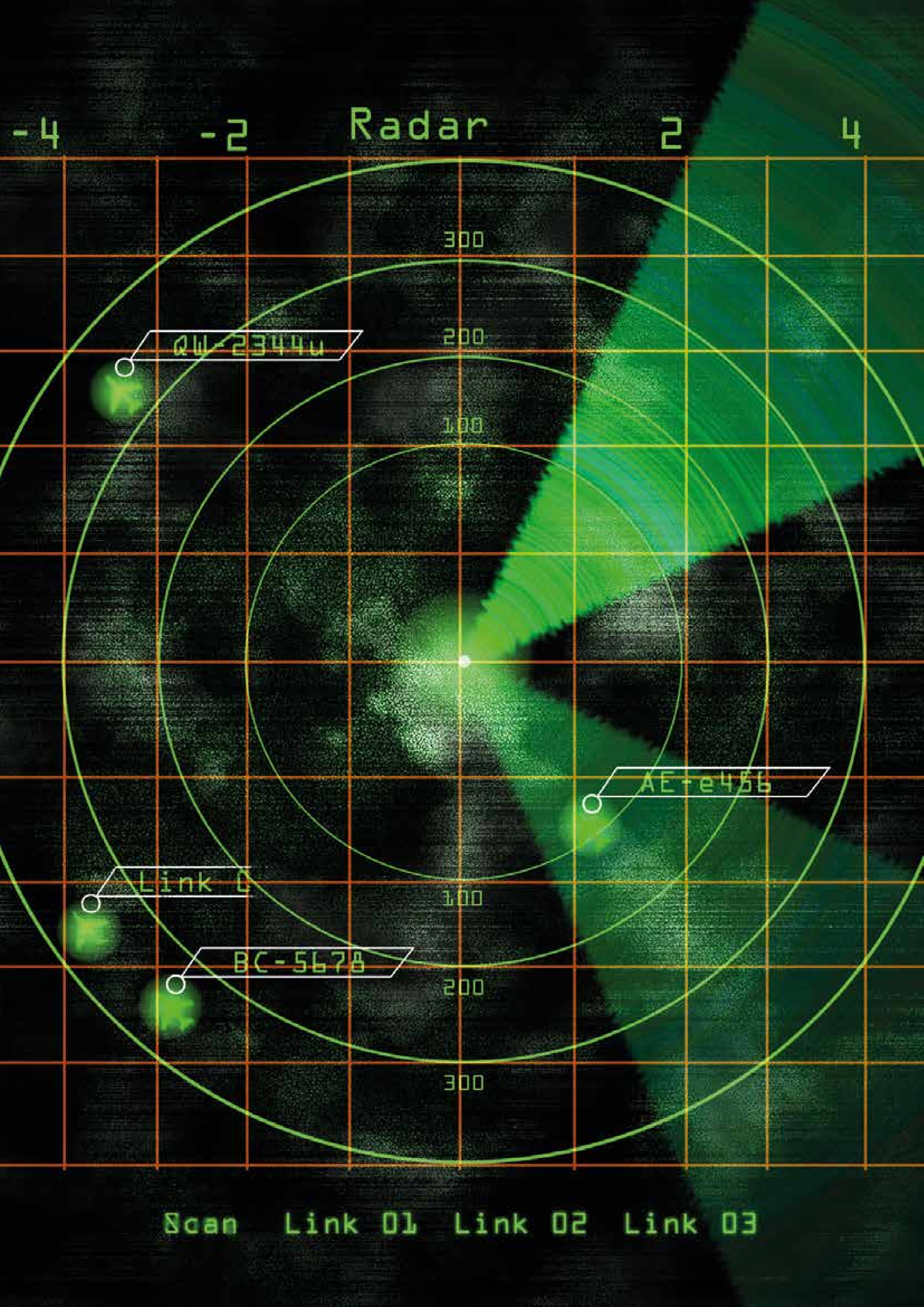
On 24 March 2014, after a six-year discussion on how to close existing loopholes in the current text of the EU Savings Directive and prevent tax evasion more effectively, the EU Council of Ministers finally adopted a broadened version of the EU Savings Directive (EUSD). The amended EUSD was however destined to be short-lived, as the intended repeal of the EUSD was announced in October 2014.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In the meantime, OECD member countries (including EU member states) had endorsed the Common Reporting Standard (CRS) for implementing the automatic exchange of information in tax matters. Any concerns over potentially lengthy discussions at EU level to implement the CRS in the European Union were also quickly put to rest through an extension of the Directive on Administrative Cooperation (DAC) during the ECOFIN meeting in October 2014. The revised DAC (including the CRS requirements on mandatory automatic exchange of information) was approved shortly thereafter, on 9 December 2014. The speed of the process mainly stems from the fact that the CRS was inspired by the FATCA Model 1 Intergovernmental Agreements (Model 1 IGAs) signed by many countries worldwide (including most EU member states) with the United States. The move towards tax transparency that accelerated sharply after the financial crisis now seems to have become a reality on a virtually global basis.

The OECD at the origin of the CRS and the link with FATCA

Legally, the CRS is based on the OECD Convention on Mutual Administrative Assistance in Tax Matters (the Convention). The Convention had previously been developed by the OECD and the Council of Europe in 1988. In response to the G20 held in London in April 2009, the Convention was amended by Protocol in 2010.

The Convention provides for all possible forms of administrative cooperation between states in the assessment and collection of taxes, and became the new international standard for the automatic exchange of tax information. Also in this area, the OECD developed a Competent Authority Agreement (which can be used as the standard convention between partner jurisdictions), and the Common Reporting Standard for exchanging tax information automatically.

Currently, over 80 countries have signed or declared that they are willing to sign the Convention, including all G20 countries, the BRICS, most OECD countries, a number of other financial centres and a growing number of developing countries.

The OECD based the CRS on the FATCA Model 1 Intergovernmental Agreement. The principles and methodologies for classifying individuals and entities and the reportable data are consequently similar to FATCA; however, with some significant differences, which are discussed below.

Within the EU, the CRS very quickly crystallised through Council Directive 2014/107/EU of 9 December 2014 (amending Directive 2011/16/EU) as regards the mandatory automatic exchange of information in the field of taxation (the DAC), applicable from 1 January 2016 (reporting in 2017 on 2016). By 19 March 2015, Switzerland and the EU had initialled an agreement regarding the introduction of the CRS from 2017 (reporting in 2018) to collect account data from 2017 and exchange it from 2018, once the necessary legal basis has been created. Further jurisdictions should quickly follow suit.

CRS/DAC improvements compared to the EUSD

The EU Commission has taken steps to favour a replacement of the EUSD by the DAC over the survival of both regimes. As the reporting scope of the CRS, introduced by the DAC, is significantly broader than the scope of application of the EUSD, the latter was to become obsolete and will be abolished. We have summarised the main comparative criteria for the EUSD, the amended EUSD and the CRS as introduced by the DAC (See table on the next page).

	Current EUSD	Amended EUSD	CRS according to the DAC
Relevant income	• Interest and similar income (distributions/ redemptions from certain UCIs invested in debt claims)	• Interest and similar income (distributions/ redemptions from all regulated investment funds invested in debt claims) • Certain life insurance products	• All types of income (including interest, dividends, gross sales proceeds), as well as account balances are reportable
Payer subject to requirements	• EUSD paying agent; i.e. the last active economic operator securing payment for the benefit of qualifying beneficial owners (essentially banks, and transfer & register agents for funds)	• EUSD paying agent; i.e. the last active economic operator securing the payment for the benefit of qualifying beneficial owners (essentially banks, and transfer & register agents for funds, certain insurance companies)	• Reporting financial institutions as defined in the DAC (including banks, investment funds, certain insurance companies, certain non-supervised entities)
Reportable person	• Individuals resident in an EU member state (or certain dependent & associated territories), and certain entities (residual entities)	• Individual residents in an EU member state (or certain dependent & associated territories), and certain entities (residual entities defined in a broader way, and blacklisted non-EU entities, trusts, foundations)	• Tax resident individuals and entities of another EU member state, and persons controlling certain types of EU and non-EU entities (controlling persons of passive NFE)

The differences in the text of the CRS compared to FATCA might, however, lead to certain operational complexities when implementing the requirements

As a result, the individual/entities concerned by the DAC will essentially be the same as those covered by FATCA, and the DAC will extend the scope of reportable income to all types of financial income. The scope of 'reporting financial institutions' under the DAC is broader than the definition of 'paying agents' under the EUSD. Under the DAC, it includes a large number of investment funds that were not considered paying agents under the EUSD (their transfer agent/register agent may have been the EUSD paying agent though), certain insurance companies (whereas insurance is excluded from the scope of the current EUSD, and the amended EUSD would only have targeted very specific life insurance contracts), and a larger number of non-supervised entities (certain holding companies). Furthermore, while EUSD reporting was limited to interest income, DAC reporting will include all financial income, as well as the reporting of balances, irrespective of income attribution or transactions. For example, in the case of capitalisation funds, an investor's units/share values held in the funds would be reported annually even if that investor makes no acquisitions or redemptions.

As a result, the EU Commission will repeal the EUSD (and the amended EUSD), causing a collective sigh of relief among financial institutions. Many market players had expressed their concerns on the survival of both the DAC and the partially overlapping EUSD regimes in parallel, which would have required a costly duplication of data, systems and processes.

The EU commission now needs to start discussions on the practicalities of phasing out the EUSD, especially due to Austria's specific situation regarding the DAC (whereby CRS reporting will start from 2017 for Austria, instead of 2016 as for all other member states). The procedures for this repeal and the operational impacts on the market players will also have to be analysed. However, this is not the most pressing challenge for market players, who are currently focused on finalising their FATCA projects, in the hope that they can leverage their FATCA experience when implementing the CRS under the DAC.

EU market players should also be aware that additional CRS reporting requirements for countries other than EU member states will enter into force in the (near) future, as and when the EU or certain states within the EU conclude bilateral or multilateral agreements with other partner jurisdictions to implement CRS reporting.

Main differences and similarities between CRS and FATCA

The CRS has been developed on the basis of Model 1 IGAs negotiated for FATCA purposes, and should, in theory, not differ substantially from the FATCA provisions. Nonetheless, the CRS is understood to be a "minimum" standard, and may give some leeway to partner jurisdictions to request additional data to be reported. Reporting processes may therefore have to be updated and extended regularly as new partner jurisdictions are added, and each country may negotiate a certain (and hopefully limited) degree of customisation of the standard reporting schema. The results of future negotiations between states and the extent of such customisation can only be guessed at. The EU member states should at least find a compromise between themselves, since they agreed on the text of the DAC. The differences in the text of the CRS compared to FATCA might, however, lead to certain operational complexities when implementing the requirements.

Which financial institutions are impacted by both regimes?

The definition of financial institutions is broadly the same under FATCA and the CRS. However, certain exemptions for low-risk entities that existed under FATCA have been removed under the CRS (e.g. certain small institutions), and there will be fewer categories of deemed-compliant status available for investment funds, leading to an increased number of investment funds with reporting obligations under the CRS.

Are there different registration requirements?

While 'reporting financial institutions' need to register on the IRS portal for FATCA purposes, there are no specific registration requirements for CRS purposes. It is possible, however, that some jurisdictions will decide to implement specific (additional) local registration requirements for FATCA and/or CRS purposes. This will need to be dealt with locally.

What will financial institutions have to report?

A 'reportable person' under CRS should be an individual or entity (other than a financial institution or certain exempt entities), tax resident within one of the participating jurisdictions. On the other hand, the purpose of FATCA was to identify and report 'specified' US persons (including US persons residing outside the US). It is therefore possible that the same person will

be a reportable person both for FATCA and CRS purposes. Multiple CRS reporting is also not excluded, as the CRS contains indicia, similar to those defined under FATCA, which, if not remediated, will result in the same person being reported on to various tax authorities.

Moreover, an important difference for entity clients is related to the fiction under CRS that all investment entities in non-partner jurisdictions are considered 'passive' non-financial entities (Passive NFEs). Consequently, controlling persons of such entities that are tax residents in a partner jurisdiction are reportable. For example, a Panama entity could qualify as a 'participating foreign financial institution' (FFI) for FATCA purposes, and an account held by that entity with a Luxembourg bank would not be reportable. But for CRS purposes, as Panama is not a partner jurisdiction (yet), and assuming the entity is an investment entity under the CRS definitions, the same bank should identify the 'controlling persons' of this entity who are tax residents in a partner jurisdiction, and consequently report on these persons.

What are the documentation and due diligence requirements?
Due diligence for CRS purposes is based on tax residence criteria. If this information is not available, financial institutions will be able to carry out a search on the same criteria as those applicable for FATCA purposes. The CRS will rely even more on self-certification than FATCA; although, under the DAC, member states have the option to introduce some flexibility to rely on AML/KYC documentation.

Regarding the documentation, many jurisdictions are trying to implement self-certification forms that would be compliant with FATCA and CRS. However, some market players are currently using US forms (e.g. the W-8 or W-9 forms), which are only FATCA-compliant. In addition, as banks are also 'qualified intermediaries' (QIs), they will need to collect these US forms for QI purposes in certain cases, leading to a potential duplication of the required documentation. It should be noted that, for CRS purposes (and contrary to FATCA), there are no *de minimis* thresholds applicable for individuals' accounts that would enable FIs to exempt certain low-value accounts from review, and that the *de minimis* thresholds for entities are defined in a slightly different way under the CRS than under FATCA.

What is the proposed timing for the reporting?
The reporting for FATCA purposes is phased reporting. The reporting due in 2015 (on the 2014 financial year) will be a simplified version: in addition to the information on account holders, only the balance and value of the accounts will need to be reported. For reporting on 2015 in 2016, FIs will need to add information pertaining to the income paid on the account. The reporting due in 2017 on 2016 will also include, in addition to the above, any gross proceeds paid to the account. The content of the CRS reporting will be the same, but there should be no phased-in implementation: the first reporting on the calendar year 2016 will immediately include the full-scope reporting of balances, income and gross proceeds.

What is the penalty for non-compliance?
Another major difference between the CRS and FATCA is the absence of punitive withholding tax under the CRS (although in IGA Model 1 countries, punitive withholding tax under FATCA would only occur in very exceptional cases). Of course, local laws transposing CRS obligations may contain certain sanctions for non-compliance; in most countries in the form of administrative fines. This should be monitored on a country-by-country basis.

Key 2015 challenges and requirements to anticipate

Several actions need to be undertaken now in order to ensure that FIs are ready when CRS reporting under the DAC enters into force (i.e. by December 2015). CRS projects (especially gap analyses with FATCA) should already have begun, and the following considerations need to be addressed:

- Strategic decisions taken for FATCA purposes need to be revisited in view of the CRS: for example, the use of the *de minimis* threshold exemption for FATCA needs to be assessed, taking into account that these thresholds will be different for FATCA and CRS purposes, thereby leading to the increased complexity of due diligence. Due to the increased volume of reporting expected for the CRS compared to FATCA, the need for an automation or an outsourcing solution for reporting needs to be considered

- Classifications of investment funds and 'in-scope' products need to be assessed in view of the available CRS status types (which is an important point for investment funds having opted for a deemed-compliant FATCA status other than CIV status, but also for the assessment of insurance products, for example, where slight differences exist in the definitions and exemptions used for FATCA and CRS purposes)

- Legal and regulatory documentation (general conditions, onboarding documentation, fund prospectuses, subscription forms and agreements, etc.) need to be updated again in view of the CRS requirements. The same applies to internal procedures for handling FATCA and CRS classification and reporting obligations

- A due diligence exercise on account holders and investors will need to be run again to assess reportable status (or not) from a CRS perspective

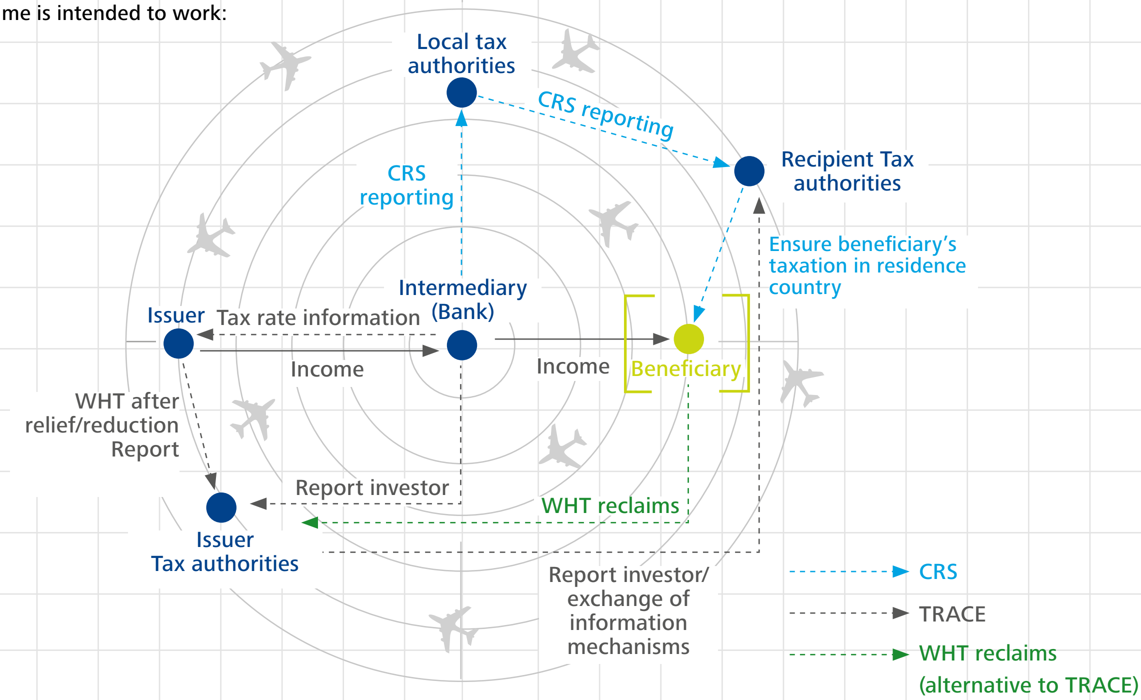
- Another challenge will be client communication. A number of clients may have been contacted recently to provide documentation in respect of their FATCA status (e.g. evidence relating to US indicia detected in their file). Financial institutions may have to contact clients again very soon afterwards to request additional information in respect of their CRS classification and possible remediation of additional CRS indicia identified in their files. The EU DAC also confirms certain information obligations towards account holders, in respect of data protection. The extent of such account holder information is still subject to discussion

- For fund service providers, data, systems and processes will also need to be updated so that they can process and centralise this new set of information

In order to ensure a successful CRS implementation project, the following key actions need to be undertaken as a matter of urgency:

- Launch an impact analysis, which makes the link with the FATCA implementation project.
  This impact analysis should assess the implementation costs, and whether the organisation would self-develop its CRS reporting systems, look at integrating an external package into the organisation's systems, or consider an outsourcing solution of FATCA and CRS reporting
- Train the existing FATCA taskforce on CRS-specific requirements, focusing on the delta between FATCA/EUSD and CRS
- Revisit the FATCA/automatic exchange of information strategy, taking into account CRS requirements
- Organise the communication strategy (for internal and external purposes)
- Identify new classification/remediation criteria and workflows applicable to CRS

How the TRACE regime is intended to work:



To the **point**:

- With the adoption and commitment to adopt the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters (including the CRS standard) by more than 80 jurisdictions, an important milestone has been reached in enhancing tax transparency on a virtually global basis. The countries that have committed to it include all EU member states, as well as jurisdictions from all continents such as Argentina, the British Virgin Islands, the Cayman Islands, the Channel Islands, China, India, Indonesia, Japan, Korea, Nigeria, Russia, Saudi Arabia, Singapore, Switzerland and South Africa. Market players need to act rapidly; in a first stage within the EU for implementation of the CRS under the DAC, and then with ongoing follow-up of additional legal instruments imposing CRS reporting with additional partner jurisdictions, and subsequent updates of client classification and reporting systems.
- Nonetheless, some further measures should be expected in order to improve CRS implementation and efficiency. As the US legislator did before FATCA with the QI regime (with which FATCA has been aligned), the next steps considered by the OECD are a withholding tax relief system ensuring relevant application of the correct amount of withholding taxes (including reduced rates under double tax treaties), depending on the identity of the beneficial owner. The OECD will therefore encourage the enforcement of the TRACE (Treaty Relief and Compliance Enforcement) initiative (which has returned to the table as CRS implementation gathers pace), with a view to giving an incentive for investors and account holders worldwide to provide sufficient relevant information to financial institutions. In October 2014, the OECD committee on fiscal affairs stated that: "TRACE will improve the quality of information collected by financial institutions for purposes of the CRS, as it provides an incentive to investors to provide complete and accurate information to their financial institutions."
- Consequently, tax regulatory compliance costs are likely to increase in the future, but should be counterbalanced by new opportunities, as investors and account holders will need increased assistance to reconcile global investment and/or account information with amounts that they need to report in their own tax returns. A greater number of market players are therefore considering providing specific investor tax reporting, in order to inform investors of the tax qualification of their realised income, depending on the rules applicable in their tax residence, and consequently facilitate compliant filing of their local tax returns.