

Trust in CRS?

The Common Reporting Standard reporting obligations in the context of trusts

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The CRS, due to start applying in 2016, will impose reporting obligations and exchange of information standards that will radically change the world of international tax planning. Trusts have been particularly targeted and may be obliged to report information in relation to their beneficiaries, settlors, protectors and trustees. In certain instances this would include the value of settlors' and beneficiaries' interests in a trust.

In recent years there has been a global movement towards greater tax transparency between countries with the aim of reducing tax evasion. The automatic exchange of information in relation to tax residents between different jurisdictions has come into being as a direct result. The most recent, and most drastic development on this front is the OECD's creation of the Standard for Automatic Exchange of Financial Account Information in Tax Matters, generally referred to in its abbreviated form of the Common Reporting Standard (CRS).

Trusts are flagged at the very outset in the introduction to the CRS. Emphasis is laid on the fact that reportable accounts include accounts maintained or held by entities which are trusts. The institutions (often including the trust itself) responsible for reporting on these accounts are also required to look through passive entities to report on individuals that ultimately control these entities. It is clear that there is an agenda in the CRS to ensure that trusts cannot be used by individuals as a shield against reporting requirements.

Section 1A of the CRS states that "each Reporting Financial Institution must report [certain] information with respect to each Reportable Account of such Reporting Financial Institution".

Whether there is a reporting obligation, and the content of that obligation, will to some extent vary depending on the nature and residence of the reporting institution involved, as well as other factors such as the residence of its account holders, or, in the case of a trust, the residence of the beneficiaries, settlor, protector, etc.

A trust would in most cases be classified as either a 'Reporting Financial Institution' (FI) or a 'Passive Non-Financial Entity' (Passive NFE). If a trust is an FI, the trust or its trustee will have an obligation to report to its local tax authority in respect of the trust's reportable accounts. Where the trust is a Passive NFE, its trustee may be required to disclose information to an FI (e.g. a bank) with which the trust holds a reportable account, so that that FI can file its report with its local tax authority.

It is therefore clear that the reporting obligations applicable in the case of a trust that qualifies as an FI differ from the disclosure that a trust that is a Passive NFE might be required to make to an FI with which it holds an account. Care should be taken not to confuse the basis for, and content of, the separate sets of obligations. When determining the reporting obligations applicable to a trust, therefore, a crucial first step would be to establish whether the trust is an FI or a Passive NFE.



Trusts as FIs

In general, a trust will be classified as an FI if it has a professional corporate trustee, i.e. a trustee which, as its primary business, invests, administers or manages the assets for trusts or other customers. It is also necessary that the trust's gross income that is attributable to investing, reinvesting or trading in financial assets is more than 50% of its total gross income.

Reporting obligations of a trust which is an FI

As FIs, trusts have an obligation to report on any 'Account' that is held by a 'Reportable Person' (i.e. a 'Reportable Account') as defined in the CRS. A 'Reportable Person' is any entity or individual who is a resident of a CRS signatory state. An 'Account Holder' is any person who, in relation to a trust that is an FI in the form of an 'Investment Entity', has an 'equity or debt interest' in the trust.

Under the CRS, "an Equity Interest is considered to be 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."

According to the CRS Commentary, beneficiaries who are purely discretionary beneficiaries (i.e. have no vested interests in the trust) should only be considered to be Account Holders in relation to a particular reporting period if there has been a distribution to them during that reporting period.

In the case of a trust that is resident in one of the early adopter countries, distributions made to a discretionary beneficiary in 2015 may already trigger disclosure obligations in the course of 2017, because accounts will be categorised as 'pre-existing' by looking at the position in December 2015.

It is important to note that a person who is a

beneficiary as well as a settlor of a trust that is an FI (qualifying as an Account Holder in both instances) would be treated as having two accounts with that trust. These will need to be assessed and reported on separately.

Any person who has made a loan to a trust is also an Account Holder, holding a 'debt interest'.

Reportable information

The information to be reported about a Reportable Account includes the Reportable Person's name, address, tax identification number, date and place of birth, and the total gross amount paid or credited to the account in respect of the relevant reporting period and the account balance as at the end of the relevant reporting period. The closure of any account held by a Reportable Person must also be reported.

The CRS does not provide any guidance in relation to the determination of the value of the interest of a beneficiary, settlor or person exercising ultimate effective control. The question therefore arises as to what values should be attributed to these parties' interests in an FI trust (i.e. the value of their 'accounts') for reporting purposes.

The value of a vested beneficiary's interest in the trust is likely to be linked directly to the value of the vested interest. In the case of a discretionary beneficiary, the value of their interest in the trust is likely to be equal to the aggregate amount of distributions in their favour in any given reporting period.

Difficult questions arise as to what the value is of a settlor's interest in an irrevocable trust compared with a revocable trust. Similarly, in the case of a person exercising ultimate effective control over the trust (for example, a trustee or a protector with significant powers), should the full value of the trust be attributed to that person?

Trusts as Passive NFEs

If the trustee of a trust is not a professional corporate trustee, the trust may not be an FI. It would therefore be classified as an NFE, and be either Active or Passive. The CRS contains a closed list of categories of Active NFEs. If a trust, which is an NFE, does not fall into one of the specific categories of Active NFEs, it is classified as a Passive NFE. The categories of Active NFE are such that, in most cases, a trust set up for wealth protection and which is an NFE will be a Passive NFE.

The CRS also defines a Passive NFE to include any 'Investment Entity' that is resident in any country that has not signed up to the CRS. The effect is to require FIs, which maintain accounts for trusts that are resident in a non-CRS country, to identify the 'Controlling Persons' in relation to those trusts and report on those Controlling Persons where they are resident in a country that has signed up to the CRS.

Reporting obligations in relation to trusts that are Passive NFEs

A Passive NFE does not have reporting obligations under the CRS. Nevertheless, in almost all cases it will have financial accounts, perhaps bank accounts, with other entities, which do have CRS reporting obligations. The FIs with which the Passive NFE has accounts will also be subject to pre-existing anti-money laundering and know your client due diligence obligations (AML/KYC obligations), which will require the FI to have identified the 'Controlling Persons' of that Passive NFE. The AML/KYC obligations will be extended by the CRS to oblige FIs to collect additional information regarding their account holders, for example, regarding tax residence and tax identification numbers. Passive NFEs make disclosures to FIs pursuant to these obligations, and as requested to do so by the FI, as an Account Holder of the FI.

Where requested by an FI with whom it holds an account (typically a bank or investment account), a Passive NFE must supply information relating to any of its 'Controlling Persons' who are resident in a CRS jurisdiction. If it fails to do so the sanction may include the categorisation of the account in question as 'Reportable'.

The term 'Controlling Persons' is defined in the case of a trust as meaning "*the settlor, the trustees, the protector (if any), the beneficiaries or class of beneficiaries, and any other natural person exercising ultimate effective control over the trust*".

From this definition it is clear that a person can be a Controlling Person of a trust without exercising any control over it (e.g. a beneficiary). Care should therefore be taken not to assume that Controlling Persons are only those who exercise ultimate effective control over a trust.

It is likely that, as in relation to an Account Holder of an FI trust (above), there will be scope for drawing a distinction between the discretionary and vested beneficiaries in the context of their being Controlling Persons. Thus, only those discretionary beneficiaries that receive an award will be treated as Controlling Persons.

Protectors and trustees are also expressly brought within the Controlling Persons definition. This is to be distinguished from the position of a trust that is an FI where trustees and protectors are not automatically included as Account Holders, although either might be persons exercising ultimate effective control over a trust.

The net effect of this is that any trust that is a Passive NFE that has an account with a bank which is resident in a CRS signatory state, may have to supply such bank information in relation to all its beneficiaries, settlors, and protectors who are residents of a CRS signatory state. And as we have seen above, this would include trusts regardless of their jurisdiction as well as trusts that might otherwise be Investment Entities in a non-CRS jurisdiction.

Thus, a person who is a resident in a CRS signatory state may well be subject to reporting under CRS in relation to a trust in a non-CRS country. If such a trust maintains an account with a bank which is resident in a signatory state, the bank would be obliged to identify the Controlling Persons of the trust and to report accordingly to its local tax authority.

Reportable information

The information to be reported by an FI (bank) in relation to the account of a trust that is a Passive NFE is the name, address and place of birth of each Controlling Person of the trust who is resident in a CRS signatory state. In addition, the FI will report the value of, and movements on, the account it maintains for the trust. The same account may be reported multiple times, in relation to multiple Controlling Persons. Unlike in the case of a trust which is an FI, the report filed by an FI regarding a Passive NFE trust does not reflect the value of the Controlling Persons' interest in a trust.

Thus, a person who is a resident in a CRS signatory state may well be subject to reporting under CRS in relation to a trust in a non-CRS country

Trust in CRS?

At the time that the US Foreign Account Tax Compliance Act (FATCA) was created as part of the US Hiring Incentives to Restore Employment Act (HIRE), there was nothing to suggest (including in the legislative history) that trusts would be treated as foreign financial institutions and thereby bear the full weight of FATCA due diligence and reporting obligations. Nor would one reasonably have expected this to be the case. Nevertheless, the drafters of the detailed FATCA regulations to implement HIRE clearly trusted the FATCA ideal to deliver their objective of worldwide transparency when they fitted trusts into the detailed regulatory framework. The various intergovernmental agreements seemingly followed that approach without question, as has the CRS. But what a tight fit it is turning out to be. While the official CRS Commentary has made progress in explaining, for example, how the concept of a financial account applies to a trust, it has clearly been an effort, and there remain a number of challenges in applying the CRS regime to trusts. Only time will tell whether those challenges can be overcome.

To the point:

- Trusts administered by a professional corporate trustee will in most cases have to report on the value of its beneficiaries' and settlors' interest in the trust
- The value of discretionary beneficiaries' interest in a trust will only be subject to reporting if a distribution has been made to them
- In relation to discretionary beneficiaries, distributions in 2015 may already trigger some disclosure obligations
- A trust which is a Passive NFE will have to disclose to Reporting FIs with which it holds accounts information in relation to its settlors, protectors, beneficiaries and trustees where they are treated as Controlling Persons
- If a trust is a Passive NFE, there will be no reporting requirements in relation to the value of beneficiaries' or settlors' interests in the trust
- The FI with which a trust that is a Passive NFE holds a reportable account will report on the full value of the account together with details of the trust's Controlling Persons