

## U.S. Position on OECD Standard Problematic for Trusts and Funds

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The United States' uncertain status as a participant in the OECD's common reporting standard (CRS) could create a logistical nightmare for the U.S. fund and trust industries if other countries decide to treat the United States as a nonparticipating country, according to practitioners.

In February 2014 the OECD unveiled a new CRS for the automatic exchange of financial account information. The CRS draws on the OECD's previous work on automatic information exchange and incorporates many of the features used in the intergovernmental agreements implementing the Foreign Account Tax Compliance Act. The OECD released the full version of the CRS in July 2014, including detailed model agreements, technical standards for data transmission, and commentary and guidance for governments and financial institutions.

To date, more than 90 jurisdictions have committed to implementing the CRS by 2017 or 2018. (In "early adopter" jurisdictions, new account opening procedures will need to be in place from January 1, 2016.) In a statement of outcomes released at the conclusion of an October 2014 meeting of the Global Forum on Transparency and Exchange of Information for Tax Purposes, a footnote to Annex II listing the status of Global Forum members' commitment to the CRS states:

The United States has indicated that it will be undertaking automatic information exchanges pursuant to FATCA from 2015 and has entered into intergovernmental agreements (IGAs) with other jurisdictions to do so. The Model 1A IGAs entered into by the United States acknowledge the need for the United States to achieve equivalent levels of reciprocal automatic information exchange with partner jurisdictions. They also include a political commitment to pursue the adoption of regulations and to advocate and support relevant legislation to achieve such equivalent levels of reciprocal automatic exchange.

It's not entirely clear if the United States is — or should be — considered a nonparticipating jurisdiction for CRS purposes. At a media briefing before the October 2014 Global Forum meeting, Pascal Saint-Amans, director of the OECD Centre for Tax Policy and Administration, said the United States is in an interesting position because it's "more than an early adopter [of the CRS]; it's the driver. It's the

country that made this largely possible" with FATCA. He added that the United States' special situation makes it difficult to classify its commitment to the CRS because it has the most advanced mechanism, has committed to some form of reciprocity that's not yet complete, and has developed the legislation that forms the basis for implementing the CRS. (Prior coverage: *Tax Notes*, Nov. 3, 2014, p. 497.)

The U.K. government, for one, isn't treating the United States as a CRS participant. In March HM Treasury issued final regulations (International Tax Compliance Regulations 2015 (S.I. 2015/878)) that allow the United Kingdom to automatically exchange bank account information with other jurisdictions under various international agreements, and the United States isn't included in Schedule 1, which contains a list of CRS-participating jurisdictions.

At a May 28 event in Washington, Julia Tonkovich, attorney-adviser, Treasury Office of International Tax Counsel, said it wouldn't make sense to put the United States in the same category as the five jurisdictions that have not yet committed to the CRS (Bahrain, the Cook Islands, Nauru, Panama, and Vanuatu). Tonkovich contended that the CRS "would not have happened... were it not for FATCA," and argued that FATCA's "unpopular" withholding provisions encouraged financial institutions and governments to build the infrastructure necessary for the CRS. (Prior coverage: *Tax Notes*, June 1, 2015, p. 1008.)

**FATCA's unpopular withholding provisions encouraged financial institutions and governments to build the infrastructure necessary for the CRS, said Tonkovich.**

Although some observers have called the CRS a "global extension" of FATCA, there are some key differences between the two regimes. Unlike FATCA, which requires financial institutions to look "only" for U.S. reportable accounts, the CRS requires financial institutions to identify the residency of all their reportable customers. Also, because the CRS does not contain many of the de minimis thresholds under FATCA, financial institutions will be required to report significantly higher volumes of information.

There are several differences in the definitions of terms under the CRS and the FATCA Model 1 IGA. Of particular concern to the U.S. fund and trust industries is that the CRS defines (under Section VIII, part D, paragraph 8 (ii) of the February 2014

document setting out the CRS) a passive nonfinancial entity to include managed investment entities that are resident in jurisdictions that don't participate in the CRS. This means that financial institutions will be required to "look through" managed investment entities in order to classify the controlling persons of any fund outside a CRS jurisdiction that holds an account. Under a FATCA Model 1 IGA, there's no need to look through managed investment entities because they're considered to be financial institutions.

Determining the controlling person of a trust is relatively straightforward, said Denise Hintzke, global tax leader of the Foreign Account Tax Compliance Initiative at Deloitte Tax LLP. "It generally means anyone who exercises control over the trust, which can include the settlor, the trustees, or the beneficiaries," she said.

However, when determining the controlling person of a fund, "it's not at all clear right now what the answer is," said Hintzke. "Some of the information that's been provided makes it sound like it could be the investors, while other information makes it sound like maybe it's the investment manager or the investment adviser."

The worst-case scenario would be if the fund's participant is determined to be the controlling person, said Hintzke. "Then you'd be talking about a mutual fund or publicly traded fund that has to pass along the information about all of their investors," she said. "Under the CRS, there's no publicly traded exception, and there are no de minimis exceptions, so it really doesn't make any difference who has foreign assets or whether the vehicle is publicly traded or not."

Hintzke said Treasury has been making the argument that because it will be providing some information via the FATCA Model 1 reciprocal IGAs, the United States shouldn't technically be treated as a nonparticipating CRS country. "But right now, my understanding is that the primary countries involved aren't quite buying into that argument," Hintzke said.

The obvious solution — that the United States formally become a CRS-participating country — isn't feasible because U.S. law currently doesn't require U.S. financial institutions to collect some of the information that foreign financial institutions are required to collect under FATCA and the CRS. The Obama administration's fiscal 2014 budget included a proposal that would facilitate the U.S. government's policy commitment contained in the Model 1 IGAs to pursue equivalent levels of automatic information exchange under domestic law. (Prior coverage: *Tax Notes*, Apr. 15, 2013, p. 237.)

So far, the Obama budget proposal has gone nowhere. Jonathan Jackel of Burt, Staples & Maner

LLP said it appears that Treasury and the IRS believe they don't have the regulatory authority to require U.S. financial institutions to collect all the information required under both FATCA and the CRS. "So the question is, couldn't Treasury just go to Congress and say, 'if we're going to play in the world with this concept of automatic information exchange — which we more or less pioneered with FATCA — then we need to change our laws to allow U.S. financial institutions to collect this information,'" said Jackel.

However, persuading Congress to make the necessary changes to U.S. law doesn't seem like a viable solution in the current political environment, Jackel said. "Maybe the election will change the landscape in some way that opens the path to getting the kinds of changes that we need for the CRS and FATCA," he said.

Another possible solution would be for the United States to negotiate with the CRS-participating countries to obtain "temporary CRS participating status" while the United States works toward making the necessary changes in U.S. law, said Hintzke.

In the meantime, U.S. financial institutions should prepare for the CRS by classifying all their entities so they can determine which ones might be caught by the CRS in another jurisdiction, said Hintzke. Financial institutions will need to determine whether they have any investment entities that would be subject to the CRS look-through rules and thus require identifying and gathering controlling person information, she added.

When asked to comment, a Treasury spokesperson pointed Tax Analysts to the comments made by Tonkovich at the May 28 event in Washington. ■