

KEY POINTS

What is the issue?

The OECD proposes to amend the Common Reporting Standard (CRS) to expand its scope to entities with accounts containing crypto-assets, to further align CRS due diligence with the Financial Action Task Force's Recommendations and increase the usability of information reported.

What does it mean for me?

Practitioners will need to be aware of the changes, which will impact on their due-diligence procedures and the information they report.

What can I take away?

The scope of the CRS is likely to be expanded to a new set of intermediaries that only recently became subject to financial regulation and to crypto-assets as financial assets.



The extended reach of the CRS

ASHLEY FIFE AND GEORGIA FOTIOU EXAMINE PROPOSED CHANGES TO THE COMMON REPORTING STANDARD AND THE LIKELY IMPACT ON TRUSTS

On 22 March 2022, the OECD published a consultation titled *Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard* (the Consultation).¹

The Consultation indicates that the OECD is:

- developing a global tax transparency framework that provides for the automatic exchange of tax information on transactions in crypto-assets (known as the Crypto-Asset Reporting Framework);
- proposing amendments to the Common Reporting Standard (CRS) to include new financial assets (including crypto-assets), products (e.g., digital financial products) and intermediaries (e.g., businesses that effect exchange transactions in crypto-assets); and
- proposing to amend the CRS to improve the due-diligence procedures and usability of information reported.

The intention is to minimise duplication of reporting. This article focuses on changes proposed to the CRS that impact on trusts.

PROPOSED AMENDMENTS

Definitions

The Consultation proposes to amend the definition of 'financial asset' in the CRS to include 'relevant crypto-assets' and

includes other new definitions to facilitate the application of the CRS to 'relevant crypto-assets'.

The Consultation proposes to extend the definition of 'investment entity' in the CRS:

- by explicitly confirming that investors in funds can be 'customers' and the funds themselves can operate 'as a business';
- to entities that invest, administer or manage relevant crypto-assets on behalf of other persons; and
- to entities whose gross income is primarily attributable to investing, reinvesting or trading in relevant crypto-assets if the entity is managed by another entity that is a depository institution, custodian institution, specified insurance company or an investment entity.

Expanded reporting requirements

The Consultation proposes that reporting financial institutions (RFIs) report the role of controlling persons reported, distinguishing between those that have an interest through ownership and those that have powers but no personal economic interest (e.g., protectors and trustees).

In respect of an equity interest held in an investment entity (that is a trust), the role/s by which the reportable person is an equity interest holder must be reported. The Consultation contemplates a two-year transition period for reporting this information.



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The Consultation also proposes RFIs to report:

- whether the reportable account is a pre-existing account or a new account and whether the RFI has obtained a valid self-certification;
- whether the financial account is a joint account and, if so, the number of accountholders; and
- the type of account that the reportable financial account is, e.g., whether the reportable person holds a debt or equity interest in the trust.

The OECD envisages this proposal will assist tax authorities in assessing the reliability of information reported and appropriately allocate the income and wealth of those reported.

Discretionary beneficiaries and account closure

The Consultation proposes that the CRS Commentary expressly provide that the account of a discretionary beneficiary of a trust that is a financial institution (FI), who has received a distribution in one year and not the following year, and has not been irrevocably excluded, is not closed by virtue of not receiving a distribution.

Reliance on AML/KYC procedures

The Consultation proposes that the CRS prescribe conditions where an FI may rely on anti-money laundering/know-your-customer (AML/KYC) procedures to identify controlling persons of an entity accountholder under the CRS, by providing for both pre-existing and new entity accounts that AML/KYC procedures must be consistent with the 2012 Financial Action Task Force (FATF) Recommendations (the Recommendations). If an FI's AML/KYC procedures are inconsistent with the Recommendations, the FI must apply substantially similar procedures to the Recommendations.

Due diligence/self-certification

The Consultation proposes that FIs validate self-certifications for new accounts.

The Consultation proposes that RFIs temporarily determine the residence of accountholders and/or controlling persons applying due-diligence procedures for pre-existing accounts. The Consultation stresses that this proposal is not an alternative to obtaining a valid self-certification.

Dual-resident accountholders

The Consultation proposes that the CRS:

- state that, where an accountholder is resident in more than one jurisdiction, all countries of tax residence must be self-certified by the accountholder and the accountholder should be treated as tax-resident in all identified jurisdictions; and
- remove tie-breaker rules (used in tax conventions) to determine jurisdiction of residence for self-certification purposes.

Integration of CBI/RBI guidance

Citizen/resident by investment (CBI/RBI) schemes allow foreign individuals to obtain citizenship or temporary or permanent residence rights based on local investments or against a flat fee.

The Consultation proposes to integrate the OECD's October 2018 explanatory guidance on the misuse of CBI/RBI schemes to preclude use of CBI/RBI schemes that circumvent the CRS.²

The Consultation proposes that:

- an FI should not rely on a self-certification or documentary evidence where it has reason to know it is unreliable;
- FIs should consider information regarding potentially high-risk CBI/RBI schemes when determining reliability of self-certifications or documentary evidence; and
- FIs be permitted to raise additional questions to determine the appropriate jurisdiction/s for CRS reporting.

Government verification services

Presently, CRS due-diligence procedures are based on AML/KYC documentation, self-certifications and other account-related information collected by FIs. The Consultation proposes that FIs may rely on government verification services to document reportable persons when performing CRS due diligence. It is proposed that the confirmation of a person's identity via government verification services or a similar process be recognised as functionally equivalent to a tax identification number.

No look-through of public traded entities

The Consultation notes that CRS due diligence requires RFIs to look through passive non-financial entities (NFEs) to ascertain controlling persons.

The Consultation proposes that the CRS acknowledge that, consistent with the Recommendations, RFIs are not required to request information on the beneficial owners of public traded entities if such an entity is already subject to adequate disclosure of beneficial ownership information.

Transition

The Consultation proposes transitional measures to include digital products within the CRS. It is proposed the same transitional measures for such FIs and financial accounts apply as when the CRS was introduced.

Non-profit entities: the active/passive NFE distinction

The Consultation requested input on whether the entities that are active NFEs by virtue of being non-profit entities (NPEs) should not be treated as investment entities. Presently, the absence of an exception from the definition of 'investment entity' for NPEs may lead to genuine public

benefit foundations applying due-diligence procedures to all beneficiaries of grants and reporting on non-resident beneficiaries. However, governments may be concerned that not classifying NPEs as investment entities enables such entities to circumvent the CRS by improperly claiming non-profit entity status. The Consultation sought input on what criteria may ensure that only genuine NPEs be excluded from CRS reporting.

OBSERVATIONS

A key focus of the proposed changes is to extend the CRS to entities that hold accounts containing crypto-assets and to align CRS due diligence more closely with the Recommendations. This is in circumstances where the FATF recently updated guidance on virtual asset service providers, has been reviewing the Recommendations' unintended consequences and has recently issued a consultation paper proposing revisions to Recommendation 25, 'transparency and beneficial ownership of legal arrangements'.³

The OECD's objective of increasing the usability of information reported might be undermined by exchanging information to each jurisdiction in which a person reported resides, without regard to tie-breaker rules. The objective of reducing the burden of the CRS on FIs may be undermined by additional due diligence and reporting obligations.

The OECD maintains and regularly updates a list of frequently asked questions (FAQs) on the application of the CRS, and proposes that these be incorporated into the CRS. In most participating jurisdictions, this would incorporate those FAQs into law.

There has been debate regarding OECD guidance that asserts:

- protectors of FI trusts be reported, irrespective of whether the protector exercises ultimate control over the trust;
- RFIs must look through FI accountholders (e.g., settlors and protectors) to report the FIs' controlling persons.

The Consultation also does not address these issues.

That the OECD is considering the burden of the CRS on non-profit organisations is encouraging. However, the Consultation does not contain draft amendments in this regard.

The Consultation does not address concerns that some participating jurisdictions might use information reported under the CRS for purposes other than detecting income tax evasion. Some participating jurisdictions have poor records regarding human rights and maintaining confidentiality of personal information.

The consultation period ended on 29 April 2022. The Consultation indicates it will provide an update to the G20 meeting in October 2022.

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#DIGITAL ASSETS #TRUSTS

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