

ICI VIEWPOINTS

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Creating a Globally Workable Compliance Framework for Financial Account Tax Information

By Keith Lawson

By developing a global standard for collecting customer information from financial institutions and exchanging that information between governmental taxing authorities worldwide, the Organisation for Economic Co-operation and Development (OECD) has taken an important step to enhance tax compliance. This common reporting standard (CRS) for the automatic exchange of information (AEOI), which was announced by the OECD on 13 February 2014, will be presented to the G20 at their 22–23 February 2014 meeting in Sydney.

The US FATCA Precedent

The AEOI CRS is based upon the first intergovernmental agreement (IGA) that was developed by the United States and five countries (France, Germany, Italy, Spain, and the United Kingdom) to ease implementation of the US Foreign Account Tax Compliance Act (FATCA). Under FATCA, non-US financial institutions with US investments effectively are required to provide, directly to the US Internal Revenue Service (IRS), specific financial information about their customers who are US citizens or residents or that are controlled by US citizens or residents. Detailed customer-identification procedures also must be followed.

Under this first version of the IGA (known as the Model 1 IGA), a non-US financial institution reports information about its US customers to its local tax authority, rather than to the IRS, using a common reporting format. This information then is provided by the local tax authority to the United States. If the IGA is “reciprocal,” the IRS provides the other country with information about its tax residents. Under the second version of the IGA (known as the Model 2 IGA), financial institutions report directly to the IRS; their local tax authorities do not receive tax information from the IRS.

What’s Driving the Global Push for Information Exchange

The OECD’s CRS is gaining substantial global momentum because of the many tax compliance benefits that governments receive from financial account information-sharing agreements. The impetus for this effort came from the five countries that worked with the United States on the Model 1 IGA; they quickly realised the additional benefits of entering into IGA-like arrangements with each other. They also recognised that the additional burdens on their financial institutions would be reduced if the new standard were based on the Model 1 IGA.

The G8 and G20 have announced strong political support for this work and have urged the OECD to develop a global standard based upon the reciprocal version of the Model 1 IGA. Among the more than 40 countries that have joined the effort are several that are members of neither the OECD nor the G20.

The Expected Impact of AEOI

As chair of the Business Advisory Group formed by the Business and Industry Advisory Committee (BIAC) to the OECD, ICI Global has been coordinating closely with the OECD, government officials, and financial industry participants worldwide to craft a workable and cost-effective regime. The group’s goals are customer identification and reporting requirements that are clear and that limit the additional burden—beyond FATCA—that AEOI will impose on financial institutions and their customers.

The CRS generally takes into account ICI Global’s concerns. One significant benefit of the CRS is that it is based on the Model 1

IGA; with only a few exceptions, its deviations from the Model 1 IGA are insignificant. The burdens imposed on financial institutions and their customers would have been much more significant if AEOI had been an entirely new regime. Nevertheless, because AEOI applies to all customers, and not just to US taxpayers, its scope and effect are far broader.

The CRS, however, is only one step in this process. For this new framework to be implemented in a cost-effective manner, ICI Global believes that:

- The OECD must develop detailed guidance, known as Commentary, explaining how governments and financial institutions are to apply the CRS.
- Governments must adopt the CRS consistently (rather than make what might be perceived as minor deviations).
- Governments must modify domestic laws (such as data privacy rules) and provide administrative guidance so that financial institutions lawfully can collect and report the required information.
- Financial institutions must create new compliance protocols, or modify the FATCA regimes built already, to accommodate the much broader reach of AEOI.

What Effect Will AEOI Have on the United States?

AEOI will have no direct effect on the United States or on the US-based operations of financial institutions. Because the United States already has FATCA, upon which AEOI is based, the United States does not need to enter into AEOI agreements to receive the information that AEOI can provide to others. Not only is FATCA already a legislative mandate (having been enacted several years ago), but it will be implemented sooner than AEOI. Moreover, because AEOI focuses only on a customer's tax residence (which is the sole basis for taxation in most of the world), and the United States also taxes on the basis of citizenship, AEOI is not sufficient for US tax purposes.

What to Anticipate Regarding a Phase-In

Though the OECD anticipates governmental agreement on the CRS Commentary by the middle of 2014, the governments expressing support for the CRS have not committed to any specific implementation date. CRS implementation, like FATCA implementation, might take place over an extended phase-in period.

Under one potential timeline being discussed:

- Any account that is open on 31 December 2015 would be an account subject to the customer identification (due diligence) rules for "existing accounts."
- Any account that is opened on or after 1 January 2016 would be an account subject to enhanced customer identification (due diligence) rules for "new accounts."
- The rigorous customer identification (due diligence) procedures for preexisting high-value accounts (i.e., those with account balances exceeding the equivalent of \$1 million) would be required to be completed by 31 December 2016.
- The first exchange of information for new accounts and preexisting high-value accounts would take place by September 2017.
- The first exchange of information for preexisting lower-value accounts would take place in 2018.

Because of the factors discussed below, it is too early to know whether financial institutions could meet their obligations under this potential implementation timeline.

ICI Global believes that any properly crafted CRS implementation timeline must reflect the substantial obligations that will be placed by the CRS on both governments and financial institutions. The time required to meet these obligations will be significant. All of the steps discussed below, and others, must be completed satisfactorily if CRS is to be implemented cost-effectively.

For example, governments will need time to:

- develop comprehensive guidance for each new compliance requirement;
- resolve any legal impediments (such as applicable data privacy laws) that would prevent compliance by their financial institutions;
- build systems to receive substantially more information from their financial institutions than will be received under FATCA; and
- exchange substantially more information with multiple countries than will be exchanged with the United States under FATCA.

Financial institutions will need time to:

- comprehend and implement the applicable guidance;
- examine their preexisting lower-value and high-value accounts;
- modify their account-opening processes;
- make the systems changes necessary to collect, maintain, and report the required information;
- test and monitor all of these systems changes;
- educate their employees, agents, and service providers; and
- educate their customers.

Many of the financial institutions' CRS implementation obligations cannot be started, let alone completed, until after the necessary guidance is provided by their governments.

To maximise the cost-effectiveness of AEOI implementation, ICI Global believes that governments also should take the time necessary to implement the OECD's Treaty Relief and Compliance Enhancement (TRACE) standard. The TRACE standard, used in conjunction with AEOI, is projected by tax experts to reduce tax-compliance costs for governments and business, and potentially increase after-tax returns for investors, by recovering more efficiently withheld taxes that are eligible to be reduced or eliminated by applicable income-tax treaties.

ICI Global Remains Committed to This Important Initiative

ICI Global will continue to work closely with the OECD, governments, and other financial industry participants on the steps that must be completed (including the CRS Commentary) before AEOI can be implemented effectively. We also will urge that sufficient time be provided for each step in AEOI implementation, to ensure cost-effective compliance. Otherwise, the burdens on fund investors and others will exceed the tax-compliance benefits that AEOI will provide to governments.

Keith Lawson is Senior Counsel, Tax Law, for ICI and ICI Global.