WHITE PAPER

An approach to being compliant with CRS

The term 'Global village', coined by the late Marshall McLuhan, is apt when it comes to the increase in cross-border businesses, and globalization of banks and financial systems. This has increased the ease with which individuals and entities can do their business and increase their market share. However, this has also helped individuals to easily hold unaccounted money in foreign countries, and thus evade tax. Tax administrators and governments around the world are trying to collect tax related to such undisclosed accounts in a bid to end bank secrecy by obtaining the customer's account data from offshore financial institutions.

Aimed at countering tax evasion, the US effectively initiated a worldwide exchange of information of US citizens' accounts information by implementing the Foreign Account Tax Compliance Act (FATCA) in 2010. Just as the financial institutions were finally settled on the FATCA implementation, a new regulation called Common Reporting Standards (CRS) is looming large on the horizon. CRS, which is largely built on the requirements of FATCA Model 1 Intergovernmental Agreements (IGA), mandates reporting financial institutions (RFIs) to report customers' foreign account information.

This white paper highlights the key differences between CRS and FATCA. It also focuses on the impact of CRS on onboarding, KYC processes, and IT systems and operations in financial institutions while recommending a possible implementation strategy for RFIs to achieve compliance.This white paper highlights the key differences between CRS and FATCA. It also focuses on the impact of CRS on onboarding, KYC processes, and IT systems and operations in financial institutions while recommending a possible implementation strategy for RFIs to achieve compliance.

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Introduction

What is CRS?

CRS, an OECD-led (Organization for Economic Co-operation and Development) initiative at the request of the Group Of Eight (G8) and the Group Of Twenty (G20), is a global reporting standard aimed at addressing perceived offshore tax evasion. The goal of CRS is to allow tax authorities to obtain a clearer understanding of financial assets held abroad by their residents.

Many countries have committed to implementing CRS in 2016 or 2017. Some of the early adopters include France, Germany, India, Ireland, Mexico, the Netherlands, and the United Kingdom. For these countries, CRS became effective from January 2016, and reporting is to begin in 2017.

Other CRS adopter countries like Australia, Brazil, Canada, Israel, Japan, Malaysia, New Zealand, Singapore, Switzerland, the UAE, etc. begin reporting in 2018.

What does CRS aim to do?

After FATCA, CRS is the next step in the move towards greater global tax transparency. The CRS rules mandate the capture of the account holder's global tax residency and financial account information. This information has to be reported to the RFI's local tax authority which is then automatically exchanged annually with the foreign tax authorities (of CRS participating countries) of those non-residents.

For example, banks in Australia will report the non-resident account holder's financial account and global tax residency information to the local tax authority – Australian Taxation Office (ATO). If one of the customers is indicated to have tax residency in India, the ATO will report this information to India's Income tax authority – Central Board of Direct Taxes. This will help ensure that Indian residents holding foreign financial accounts comply with India's tax law.

In parallel, the ATO will receive financial account information of Australian residents from other countries' tax authorities. This will help ensure that Australian residents with financial accounts in other countries are complying with the Australian tax law. This acts as a deterrent to tax evasion.

Whom does CRS affect?

CRS will be applicable to financial institutions that have custodial accounts, depository accounts, cash value insurance and annuity contracts, certain debt or equity interest accounts, investment entities, and specified insurance companies.

The CRS reportable financial information includes dividends, interests, account balance, income from certain insurance products, returns from the sale of investments, and income from assets held in the accounts.

Accounts and products held by individuals and business entities are reportable. Financial information about persons controlling these business entity records also has to be reported.

First FATCA, now CRS – Are they similar?

FATCA is a US federal law, enacted in 2010, which enforced the reporting of US tax residents' customer and account information. Since CRS shares many similarities with FATCA, CRS is informally referred to as GATCA (Global FATCA).

CRS is modeled on and closely follows FATCA regulations. However, there are some important underlying differences between the two.

The definition of an RFI differs between FATCA and CRS. So, even if that institution was not required to report under FATCA, it may be required to do so, under CRS.

A number of exemptions that are provided under FATCA such as pension funds, local financial institutions, and such, are not provided under CRS.

Differentiating Factor	FATCA	CRS
Withholding penalty	• FATCA has a 30% withholding penalty, if non-compliant • Domestic law financial penalties for minor breaches	• CRS does not have the withholding penalty • There may be other domestic enforcement penalties for non-compliance
Reportable persons	• US persons, including US citizens and US tax residents living overseas • US established partnerships, companies, or trusts US FATCA requires US citizens and residents that directly or indirectly hold financial accounts to be identified and reported.	• CRS will exclude US tax residents, who will remain reportable under FATCA • Identification of taxpayers under CRS extends to all jurisdictions worldwide The CRS will require the residence of all reportable direct or indirect account holders to be reported.
Applicability of de minimis limits	The following account balances are in-scope for FATCA: • Individual and Depository Accounts with balances exceeding US$50,000 • Entity Accounts with balances exceeding US$250,000 (not eligible if opened on or after 7/1/2014 and before 1/1/2015)	None (except US$250,000 de minimis limit for pre-existing entity accounts)
Documentation	Forms W-8 and W-9	CRS self-certification
Reporting for multiple jurisdictions (for same account)	Not applicable	Numerous instances of reporting for individuals / entities that fall under many jurisdictions

Figure 1: CRS and FATCA differences

As seen from the table above, the scale of CRS is much greater – it impacts a larger volume of customer base than FATCA, has more products in scope, and has more reportable financial account information. Hence, FATCA compliance will not make the CRS-compliance process easy for the RFIs.

Getting ready for CRS

New due diligence procedures have to be applied for customers and accounts (new-to-bank and pre-existing) as part of CRS reporting. The system must be capable of capturing the customer's tax residency details, conducting indicia searches and reporting relevant information to the respective tax authorities.

Indicia search is the ability to identify any linkage of the customer to the reportable jurisdiction.

There are several indicia parameters as listed below:

Indicia Type	Indicia Description
Current Mailing / Residential Address (Individual) Business Address (Business entity)	Customer data indicating an address in a reportable jurisdiction
Hold Mail Instruction / Care-of Address	Customer data indicating a hold mail instruction / care-of address in a reportable jurisdiction
Contact Number	Customer data indicating one or more contact numbers in a reportable jurisdiction and no contact number in the jurisdiction of the RFI
Standing Instruction	Customer data indicating a standing instruction placed in/to an account in a reportable jurisdiction
Power of Attorney or Signatory Authority	Customer data indicating a currently effective power of attorney or signatory authority granted to a person with an address in a reportable jurisdiction
Self-Certification	Self-certification provided by the customer that they are a resident of a reportable jurisdiction

Figure 2: CRS Indicia Parameters

Impact of CRS on business processes and operations

The main systems and processes impacted by CRS are:

- Know your customer (KYC) and anti-money laundering (AML) processes
- Client onboarding systems
- Customer master database
- Compliance reporting systems
- Customer accounting systems
- Document management systems

Process changes for CRS:

- The existing KYC / AML procedures and client onboarding / account opening procedures need to be upgraded to ensure the capture of the CRS relevant fields. For example, if the current systems do not capture the customer's foreign tax residency and the respective foreign taxpayer identification number of those countries, the system will have to be enhanced to capture these CRS fields.
- A self-certification form needs to be collected from the business customer. An authorized individual would need to sign this form on behalf of the business customer and indicate their capacity (Controlling Persons, Signatories, Power of Attorney, etc.) in the organization.
- Existing customer records and accounts that need to be reported need to be identified. The system needs to conduct indicia searches on such pre-existing customers' records.
- Due Diligence Process for the reportable information: Indicia checks, for change of circumstances which could trigger the need to verify the existing CRS information, must be performed daily. Alerts need to be set up based on these findings.
- Where there are any indicia findings with CRS, a case needs to be opened for such customers, if no case exists already. Correspondence (paper or digital) needs to be sent to the customer, who needs to take further action within a specified duration. System must be capable of sending this correspondence to the relationship manager also, for high value customers.
- Processes must be set up to send reminders, before the due date, to customers with open cases.
- The CRS details of such customers, who respond to the correspondence, must be captured and the case must be closed.
- If customers do not respond to the correspondence within the specified time, such customers must be treated as 'CRS Reportable'.
- Customers reportable to multiple jurisdictions must also be handled.
- Annual CRS reporting must be done to the local tax authority.

Customer Data

For Account holder and Account Controlling person

- Tax residency country
- Foreign tax number
- Full name
- Date of Birth
- Residential/mailing address

Account Data

- Account number
- Account type
- Account flags (Undocumented, Closed)
- Account holder type
- Account balance of the reported financial account
- Account payment type
- Account payment amount – aggregated value for each Payment Type
- Account payment currency

Figure 3: CRS data elements to be captured for customer records and accounts

Suggested road map for CRS compliance

The below picture shows the customer onboarding value chain that can be set- up / enhanced for the CRS implementation:

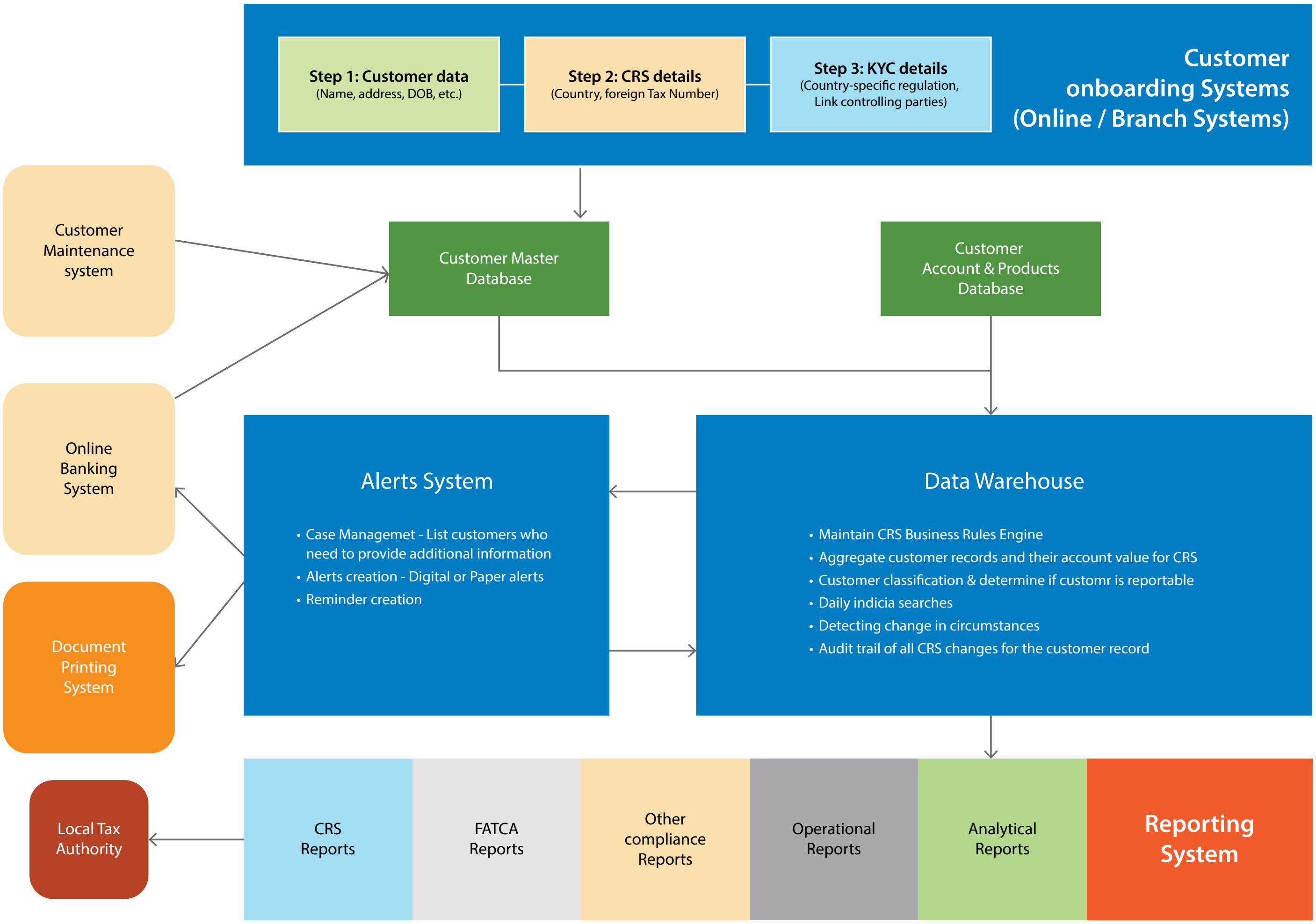

Figure 4: CRS-Impacted Systems

- To accommodate CRS requirements, RFIs could either look at enhancing their existing systems or building new systems. Based on the RFI's IT readiness, the new systems could either be in-house solutions or external ready-to-use solutions.
- RFIs could also consider leveraging their existing FATCA-compliant due diligence process to meet the new CRS requirements. Since FATCA continues to be applicable for US customers, CRS processes would need to run in parallel to the existing FATCA account holder identification and reporting solution.
- Considering that similar compliance requirements could come up in the future, the changes being done to IT systems must be scalable enough to handle those requirements with minimal changes.
- RFIs need to look to enhance the mobile / online banking capabilities to enable sending digital correspondence to the customers with mobile / online banking, allowing customers to update their CRS details online.

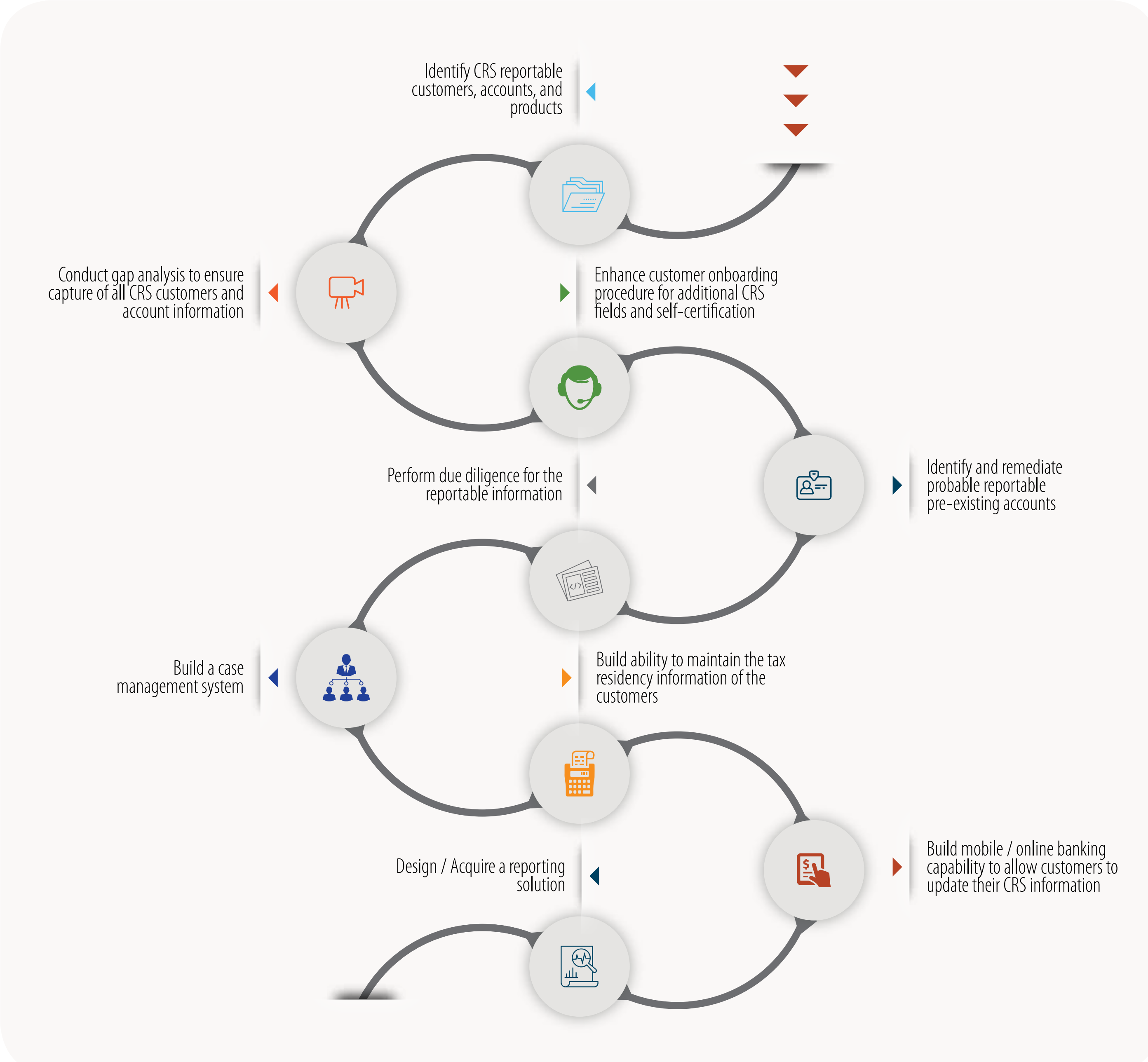

Figure 5: Suggested CRS Road Map

Customer

- Maintenance of customer experience at existing service levels, despite increased customer information capture

Business

- A scalable system-based solution that can accommodate CRS volumes and future regulatory requirements
- Optimized business processes and automated solutions, where appropriate

Figure 6: Non-functional requirements that RFI can adopt

Conclusion

CRS compliance requires dealing with huge volumes of customer records, handling complex rules, and maintaining audit trails – all of which require a well thought-out approach. Financial institutions will need to work towards delivering a durable and scalable solution for identifying, classifying, and reporting the customer's financial account details. However, this should not be done in a hasty manner as it may result in investing in the wrong systems and may prove expensive in the long run.

Good planning will ensure effective implementation of the CRS solution to achieve compliance, besides delivering added value to the business.

References:

https://www.oecd.org/tax/automatic-exchange/common-reporting-standard/

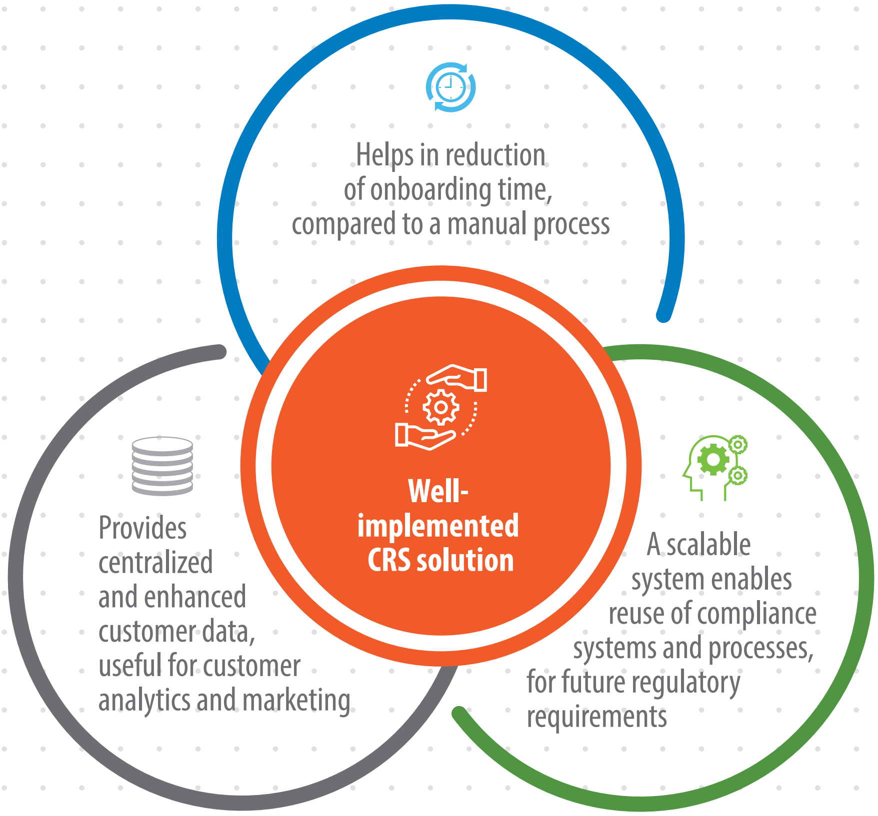

Figure 7: Benefits of a well-implemented CRS solution

About the Author

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