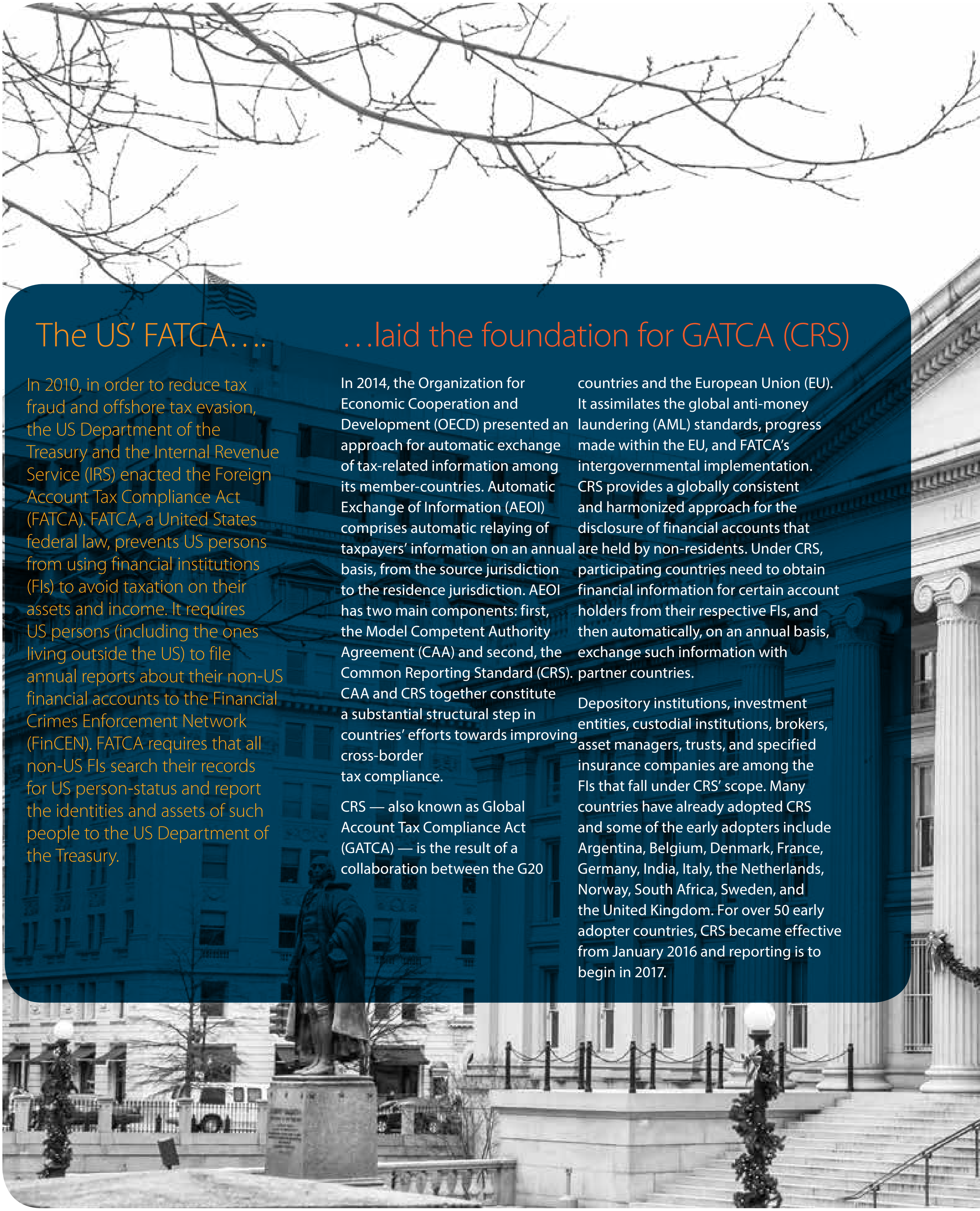
WHITE PAPER

FIs: It would be a folly to treat GATCA as FATCA 2.0



The US' FATCA….

In 2010, in order to reduce tax fraud and offshore tax evasion, the US Department of the Treasury and the Internal Revenue Service (IRS) enacted the Foreign Account Tax Compliance Act (FATCA). FATCA, a United States federal law, prevents US persons from using financial institutions (FIs) to avoid taxation on their assets and income. It requires US persons (including the ones living outside the US) to file annual reports about their non-US financial accounts to the Financial Crimes Enforcement Network (FinCEN). FATCA requires that all non-US FIs search their records for US person-status and report the identities and assets of such people to the US Department of the Treasury.

…laid the foundation for GATCA (CRS)

In 2014, the Organization for Economic Cooperation and Development (OECD) presented an approach for automatic exchange of tax-related information among its member-countries. Automatic Exchange of Information (AEOI) comprises automatic relaying of taxpayers' information on an annual basis, from the source jurisdiction to the residence jurisdiction. AEOI has two main components: first, the Model Competent Authority Agreement (CAA) and second, the Common Reporting Standard (CRS). CAA and CRS together constitute a substantial structural step in countries' efforts towards improving cross-border tax compliance.

CRS — also known as Global Account Tax Compliance Act (GATCA) — is the result of a collaboration between the G20 countries and the European Union (EU). It assimilates the global anti-money laundering (AML) standards, progress made within the EU, and FATCA's intergovernmental implementation. CRS provides a globally consistent and harmonized approach for the disclosure of financial accounts that are held by non-residents. Under CRS, participating countries need to obtain financial information for certain account holders from their respective FIs, and then automatically, on an annual basis, exchange such information with partner countries.

Depository institutions, investment entities, custodial institutions, brokers, asset managers, trusts, and specified insurance companies are among the FIs that fall under CRS' scope. Many countries have already adopted CRS and some of the early adopters include Argentina, Belgium, Denmark, France, Germany, India, Italy, the Netherlands, Norway, South Africa, Sweden, and the United Kingdom. For over 50 early adopter countries, CRS became effective from January 2016 and reporting is to begin in 2017.


TREASURY DEPARTMENT

CRS and FATCA: Comparison

FATCA Model 1 Intergovernmental Agreement (IGA) forms the foundation for CRS. Hence, it is no surprise that both CRS and FATCA have similarities; for example, compulsory reporting of the account balances, reports submission to the local tax authority, etc. However, the two have substantial differences, as listed below:

Dimension	CRS	FATCA
Standardization	• Standardized concepts, terms, and approaches	• Terms of agreement are negotiated as part of the IGAs
Governing authority	• Over 95 separate tax jurisdictions • More than 75 jurisdictions signed • Over 55 early adopters	• United States
Withholding	• No withholding	• 30 percent withholding on the non-compliant intermediaries / payees
Scope of reporting	• Is dependent upon the tax residency	• Is dependent upon the residency and/or citizenship
Reporting to multiple jurisdictions **(for same account)**	• Can involve numerous instances of reporting for individuals / entities that fall under many tax jurisdictions	• Reporting to numerous jurisdictions not involved
Reporting of account holder's tax residence	• Required	• Not required in the IRS reporting format
Entity classification	• Fewer entity classes than that of FATCA	• More entity classifications. For example: ◦ Non-participating financial institutions (NPFIs) ◦ Non-financial foreign entities (NFFEs) ◦ Deemed compliant FIs ◦ Registered deemed compliant FIs
Account in scope	• Entity and individual accounts held by the tax residents of any of the participating jurisdictions • Passive non-financial entities (NFEs) with controlling persons who are residents in any of the participating jurisdictions	• US entity accounts • US individual accounts • Passive NFFE accounts of significant US owners
New accounts (of preexisting account holders)	• Same as FATCA, but not allowed in cases where holder of a preexisting account is needed to provide amended, additional, or new customer information (owing to contractual, legal, regulatory, or operational requirements)	• New accounts of preexisting clients are allowed to be treated as preexisting accounts, if it is permitted for the FI to satisfy AML / 'know your customer' (KYC) procedures for the new account by relying on the AML / KYC procedures that were performed for the preexisting account

Closed accounts	• Only the account closures have to be reported • Reporting the account balance prior to closure not mandatory	• Account balance prior to closure has to be reported
Thresholds **(individual account holders)**	• No minimum threshold; all accounts subject to review	• For preexisting individuals: US$50,000 (in general); and US$250,000 (cash value insurance) • For new individual: US$50,000 Accounts with a balance below the threshold are exempted from reporting and review
Thresholds **(entity account holders)**	• Minimum threshold: US$250,000 (only for preexisting entity accounts)	• Preexisting entity accounts with a balance below US$250,000 are exempt from reporting and review
Exemptions	• There are no jurisdiction-wise exemptions	• Each IGA has specific exemption lists that are applicable for the particular jurisdiction
Documentation requirements	• US tax forms not acceptable for capturing all CRS data (e.g., CRS legal entity classification, several tax residences) • CRS self-certifications need to be developed	• Forms W-8 / W-9 could be used to denote all of the tax data
Sponsored entities	• Category not defined; CRS applies to the sponsored entities under FATCA	• Category is available and special rules apply

Table 1: Comparison of CRS and FATCA

CRS: Much more challenging than FATCA

FIs that need to adopt CRS would find it a much more challenging task than FATCA, for the following reasons:

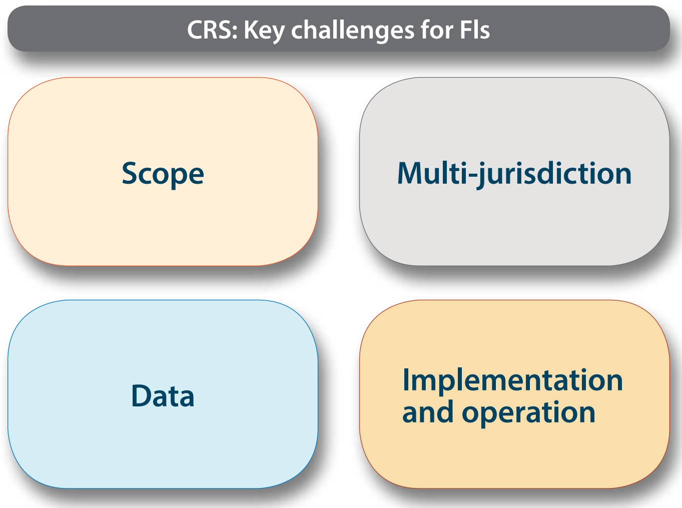


Exhibit 1: Key CRS challenges for FIs

1. Scope

As seen in Table 1, on many dimensions, CRS' scope is much broader than that of FATCA. While FATCA is concerned with US persons only, CRS covers multiple countries. In comparison to FATCA, CRS encompasses many more accounts, individuals, and entities. Some low-risk FIs, certain retirement funds, FIs with only low-value accounts, certain investment trusts, along with some investment managers and advisors are examples of entities, which although excluded from FATCA Model 1 IGA, come under the scope of CRS. Product ranges exempt from reporting also vary between CRS and FATCA. For example, equity interests in exchange-traded funds (ETFs) are considered as financial accounts under CRS. FIs would therefore need to reassess each of their products to see if these create a reportable account. Many of FATCA's de minimis limits do not apply in CRS. All of the aforementioned factors significantly increase the scale of CRS reporting by FIs. For example, under FATCA, the volume of US persons reported are usually in the low thousands. On the other hand, a UK 'high street' bank alone has estimated that many millions of its customer accounts would become reportable under CRS.

2. Multi-jurisdiction

CRS is still evolving. There is a lack of clarity vis-à-vis reporting and other details for participating jurisdictions. CRS needs to be translated into the domestic laws of the participating countries. A series of bilateral and multilateral agreements, along with enabling legislation, would have to be put in place. Managing the detailed requirements as applicable across various jurisdictions will be quite challenging for FIs.

CRS is heavily dependent upon local jurisdictions' AML / KYC requirements and the account holders' self-certifications. Owing to the varying related formats and requirements across the countries, FIs would face difficulties in standardizing their approaches. CRS' tax residency laws vary across jurisdictions and are complicated. This makes the validation procedures challenging. Filing, registration, and follow-up approaches, for tax authorities also vary from one country to another.

CRS reporting schemas may not be common across jurisdictions and there are possibilities of local variations. In the absence of an optimally automated solution, FIs will face difficulties in reporting to local tax authorities.

3. Data

While FATCA is a 'one-to-many' regulation, CRS has 'many-to-many' implications. Consequently, under CRS, over ten thousand permutations of automatic data transfer are possible. The data volume would be especially large for FIs that have a substantial investor or customer base outside their home country. Identification and collection of a wide range of data to meet the CRS reporting needs will be very challenging. For example, for a reportable person having multi-country implications, the person's entire account balance / value and their entire income or gross proceeds need to be reported to each of the concerned participating countries. In integrated regions like the EU, the huge scale of reporting requirements will render any manual or semi-manual reporting solution ineffective. Additionally, FATCA implementation experiences have shown that maintaining data quality is a huge challenge for many FIs. This challenge is only going to grow under CRS.

Entity classifications under CRS and FATCA are not the same in all of the cases. For example, under CRS, investment entities in the non-participating countries are considered passive NFEs and require look-through to identify the controlling persons. FIs' IT systems will need to be enhanced to capture such classifications and requirements. FIs will be hard-pressed in dealing with challenges related to data readiness for each jurisdiction, tracking these myriad data elements, and adhering to jurisdictions' local data privacy rules. Many countries' domestic data protection rules can limit FIs' ability to collect tax residency information on preexisting accounts.

CRS creates new documentation requirements for FIs. For instance, FIs need to enable self-certification processes and systems for capturing data about multiple tax residency, legal entity classification, date of birth, etc. They also need to put in place, systems and processes for cross-validating such self-certification information against existing KYC / AML information, for cases where the FI believes that the self-certified information is incorrect or unreliable.

4. Implementation and operation

Several FIs have taken tactical approaches towards their FATCA implementation. For example, some created temporary manual processes, some simply chose to close accounts of US individuals to reduce FATCA reporting, while others centralized their US investments under one entity. Such FIs will not be able to upgrade their existing FATCA systems to meet some of the CRS requirements. Instead, they will have to make heavy investments in new, flexible IT solutions. Many FIs are also beset with a large number of siloed and inflexible legacy systems. Integrating new, flexible IT systems and business processes with these legacy systems, for CRS compliance, will be a huge challenge for such FIs. Issues related to end-to-end reporting and workflow enablement, compliance with complex schema structures, and data identification and integration are all going to inevitably crop up. FIs would require many more resources and would need to establish and ensure unified, cross-team efforts to be ready for CRS.

CRS also creates a huge operational burden for FIs vis-à-vis the classification and remediation of existing clients. There would be a significant increase in FIs' customer onboarding, KYC, due diligence, governance, and data monitoring and reporting obligations. For customer data monitoring and due diligence, FIs may be required to store more than one classification for an investor / customer with multiple tax residences. They would also need to diligently update all changes to the customers' status or residence.

CRS is heavily dependent upon a local jurisdiction's AML and KYC requirements. As these requirements vary across jurisdictions, global FIs would face difficulties in homogenizing their approach. Differences in the final CAAs agreements between jurisdictions may only compound these challenges. New approaches towards reporting portals will also be required. Currently, for CRS, no single platform exists to facilitate reporting across the multiple jurisdictions. Existing web-based portals of tax authorities vary widely in terms of complexity across countries.

FIs' attempts to standardize the approach for account holders' classification would also be challenging, owing to the differences between CRS, FATCA, and European Savings Directive (EUSD). Further, the few variations in indicia for CRS and FATCA Model 1 IGA (such as the exclusion of standing instructions from depositary accounts) would cause operational complications for FIs (which need to comply with both CRS and FATCA).

End note

CRS and FATCA have similar goals, and superficially, they both have similar characteristics. FIs can, to a certain extent, leverage their existing FATCA analyses, systems, tools, processes, and programs for CRS adoption. However, relying on these alone will be a huge mistake. Effective CRS adoption, in a multilateral context, would require FIs to implement new IT systems, business processes, and controls. Before this, they need to carefully perform a 'gap assessment' of their current IT systems, business processes, and controls vis-a-vis the CRS requirements. Alas, many FIs have taken a laidback approach and have not yet initiated their preparation for CRS adoption. Such FIs need to note with urgency that CRS is not FATCA 2.0.

About the Author

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Anjani has over 19 years of comprehensive IT, domain, and process consulting experience. Currently, he manages several strategic initiatives including the Competency Development Program and Thought Leadership showcasing efforts. Over the years, he has provided consulting services and managed many large and critical IT engagements for numerous key clients. He was also recognized as the lead process auditor for the IT division of a major global bank. He has extensive techno-functional skills and an in-depth understanding of quality and process models – CMMI, Six Sigma, ITIL, etc.

Anjani holds a Bachelor of Engineering degree from IIT Roorkee and, over the years, has earned many reputed and industry-recognized domain and process certifications.

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