Issue

06

Regular journal of exploiting Common Reporting Standard weaknesses

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Issue highlights

EU Code of Conduct Group (business taxation) assesses every country in the world if it is an uncooperative tax haven. The criteria for being grey listed is failure of two out of three of the following criteria (i) commit to tax transparency, (ii) fair tax competition and (ii) disallow booking of untaxed profits without real economic activity.

Why unit-linked disability and unit-linked surety bonds are reportable financial accounts despite claim to the contrary of the insurers.

Domestic law low-risk excluded accounts are complex and difficult to attain.

The single dumbest loophole in the CRS is the exclusion from review and reporting if a pre-existing individual owns an insurance wrapper whose jurisdiction did not allow the policy to be bought from the insurer's jurisdiction.

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"EU Code of Conduct Group (business taxation) The hidden power in the EU to blacklist, grey list and sanction uncooperative tax havens

The EU Commission has taken over from the OECD pressurizing non-CRS participants to implement the Common Reporting Standard. They have drawn up scoreboard of all 241 country and jurisdictions for tax purposes. They excluded 28 EU members states, 48 UN listed least developed countries, countries with no economic data (e.g. Christmas Island) and five 3rd party countries with tax transparency agreement with EU (e.g. Switzerland). They then assessed the remaining 160 countries on three factors (1) Economic ties with EU (trade, FDI, EU affiliates), (2) Financial activity in country (FDI, interest, dividends, royalty flows), and (3) Stability to see if the jurisdiction would be considered by tax avoiders as a safe place to place their money, (corruption, regulatory control).

They removed 60 countries from countries that did score high in any of the 3 selection criteria.

The Commission assessed the remaining jurisdictions on the potential risk level facilitating tax avoidance and listed the countries which failed two of the following three criteria (a) **Transparency**: committed to CRS, (b) **Fair tax competition**: no preferential tax regime and applies anti-BEPS, (c) **Real Economic Activity**: No corporate income tax or allowing booking of untaxed profits without economic activity allowing artificial tax structures.

Black list: refuses to engage with the EU or to address tax good governance shortcomings.
Grey list: promised to rectify risk shortfalls but will be monitored by EU.

EU COMMISSION
25 May 2018

Black list (Annex I)

7 jurisdictions

American Samoa, Guam, Namibia, Palau, Samoa, Trinidad and Tobago, US Virgin Islands

Grey list (Annex II)

65 jurisdictions

Albania, Andorra, Anguilla, Antigua and Barbuda, Armenia, Aruba, Bahamas, Bahrain, Barbados, Belize, Bermuda, Bosnia and Herzegovina, Botswana, British Virgin Islands, Cabo Verde, Cayman Islands, Cook Islands, Dominica, Republic of Korea, Curacao, United Arab Emirates, Faroe Islands, Fiji, Granada, Greenland, Guernsey, Hong Kong, Jamaica, Jersey, Jordan, Lichtenstein, Labuan Island, Macao SAR, Qatar, Former Yugoslav Republic of Macedonia, Malaysia, Maldives, Isle of Man, Marshall Islands, Morocco, Mauritius, Mongolia, Montenegro, Nauru, Niue, New Caledonia, Oman, Panama, Peru, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, San Marino, Serbia, Seychelles, Switzerland, Swaziland, Taiwan, Thailand, Tunisia, Turkey, Turks and Caicos Islands, Uruguay, Vanuatu, Vietnam

Moved from black list to grey list
Bahamas and Saint Kitts and Nevis

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Growl of this issue

Why does the CRS definition of investment entity exclude NFEs that are Active NFEs of the 4 types subparagraph D(9)(d) through (g)? These are (d) holding NFEs; (e) start-up NFEs; (f) NFEs that are liquidating or emerging from bankruptcy; and (g) treasury centres.

Two questions on this carve out…Why not exclude other NFEs that are Active NFEs because they meet criteria CRS page 58 Paragraph (9)(a)-(c) and (9)(h) i.e. Income & asset 50% test, regularly traded, government / international / central bank, and genuine charity.

This carve out is a moot action because the carve out exclusion is only for NFEs that meet Active NFE criteria. Therefore, an NFE could not be an Investment Entity. The exclusion does not apply to entities that are already investment entities.

Is a welfare, disability & long-term Care unit-linked policy a reportable financial account?

Some insurers provide segregated unit-linked WDLTC policies and erroneously claim they are not a Reporting Financial Institutions.

Policy description:
The policy holder makes a single or multiple premium, which are placed in a segregated account. In-kind premiums may be private investment companies, or hard assets (yachts, etc.). The duration of policy is set by policy holder. The policy holder designates the Custodian bank. The insurer will transfer the premium into segregated bank account at the Custodian bank in the name of the insurer.

Cancelation or irrevocable:
Policyowner has an option to be able to cancel at any time. Otherwise, policyowner can elect no cancellation to simulate an irrevocable insurance policy. The insurer will pay back the policyholder if no claim is made by the end of the policy term. So, the irrevocable "option" is a sham.

False claim that policy is not in scope of CRS:
The crux of their fallacious argument is that the assets being held by the insurer are "reserves against a stated liability". Thus, they incorrectly claim, there is no cash value as there may be a payment made for disability, welfare or long-term care. A second wrong claim by insurer is that there may not be any cash value if insurer has made a trigger event payout.

Reasons why this type of policy is CRS reportable:

1. Revocable: If policyholder can cancel policy, then there is a calculatable surrender value, which makes the policy a standard reportable cash value policy.
2. Irrevocable: If policyholder cannot revoke policy, he will obtain the cash value of the underlying assets. However, policyowner cannot access the assets during the policy term. The OECD CRS FAQ update of June 2018 page 19 clarified that the policyowner is to be treated as reportable account holder.

> "*In cases where, considering the above paragraph, no person can access the Cash Value or change the beneficiaries, the Account Holder is any person named as the owner of the contract and any person with a vested entitlement to payment under the terms of the contract.* Notwithstanding the above, upon maturity of a Cash Value Insurance Contract (i.e. when the obligation to pay an amount under the contract becomes fixed), each person entitled to receive a payment under the contract is to be treated as an Account Holder."

Surety bonds, same sham different texture

Caribbean insurers assist Principals avoid CRS with surety bonds

An obscure financial product is being used to circumvent the CRS. Although it's a $100 billion market, banks and other FIs involved with CRS hardly ever encounter surety bonds. Easiest way to understand surety bonds is videos on YouTube. In summary an Obligee requires a builder to provide surety that they will perform on the project. The builder, known as Principal, will pay small fee to surety company who will pay Obligee if Principal builder does not perform. Surety provider will then come after Principal for repayment. To avoid CRS, the Principal provides Surety company with collateral which is held in a segregated account. This collateral is a portfolio of investments. At maturity or cancellation, the Principal receives back his invested capital.

What is the 80% activities for NFE Holding Companies to qualify as an Active NFE? Is it the shares it holds, or the dividends it earns. Could it be some other metric such as staff, manhours or balance sheet value.

Definition of holding company Active NFE CRS page 58 par(9)(d) - The term "Active NFE" means substantially all of the **activities** of the NFE consist of holding (in whole or in part) the outstanding stock of, or providing financing and services to, one or more subsidiaries that engage in trades or businesses.

"**Substantially all**" Commentary page 197 par(130) means **80%** or more. If, however, the NFE's holding or group finance **activities** constitute less than 80% of its activities but the NFE receives also active income (i.e. income that is not passive income) otherwise, it qualifies for the Active NFE status, provided that the total sum of **activities** meets the "substantially all test".

For purposes of determining whether the **activities** other than holding and group finance activities of the NFE qualify it as an Active NFE, the test of subparagraph D(9)(a) can be applied to such other activities. For example, if a holding company has holding or finance and service activities to one or more subsidiaries for 60% and also functions for 40% as a distribution centre for the goods produced by the group it belongs to and the income of its distribution centre activities is active according to subparagraph D(9)(a), it is an Active NFE. irrespective of the fact that less than 80% of its activities consist of holding the outstanding stock.

Explanation in plain English

1. The activities could be financing subsidiaries, so this is not holding shares or receiving income.
2. Activities refer to income - If Activities constitute less than 80% of its activities but the NFE receives also active income provided total sum of activities meets 80%
3. Also functions for 40% as a distribution centre and the income of its distribution centre activities is active

All this indicates the activities is an income test.

Dilemma: What if 80% of shares an NFE owns is subsidiaries that engage in business or trade, and 20% shares are say income investment equity. What if the income from the 20% investment shares is more than 80% of the total income. According to definition of activities being income, this NFE would be a passive NFE.

Investment Entities cannot be reclassified as Active NFEs

There is a single clause in the CRS and Commentary that causes the most misinterpretation and hence results in a fake loophole being pursued and implemented.

CRS page 45 par(6)(b) and Commentary page 162 par(19) states 19. The term "Investment Entity", as defined in subparagraph A(6), does not include an Entity that is an Active NFE because it meets any of the criteria in subparagraphs D(9)(d) through (g).

The Active NFEs excluded from being an investment entity are Active NFEs because they are a **NFEs (not investment entities) which** meets criteria D(9)(d) through (g).

These do not apply to Investment Entities that are holding entities and treasury centres that are members of a nonfinancial group; start-up investment entities; and NFEs that are liquidating or emerging from bankruptcy.

Trustees making an egregious error in misinterpreting the CRS to think there is a holding Active NFE loophole for the trust

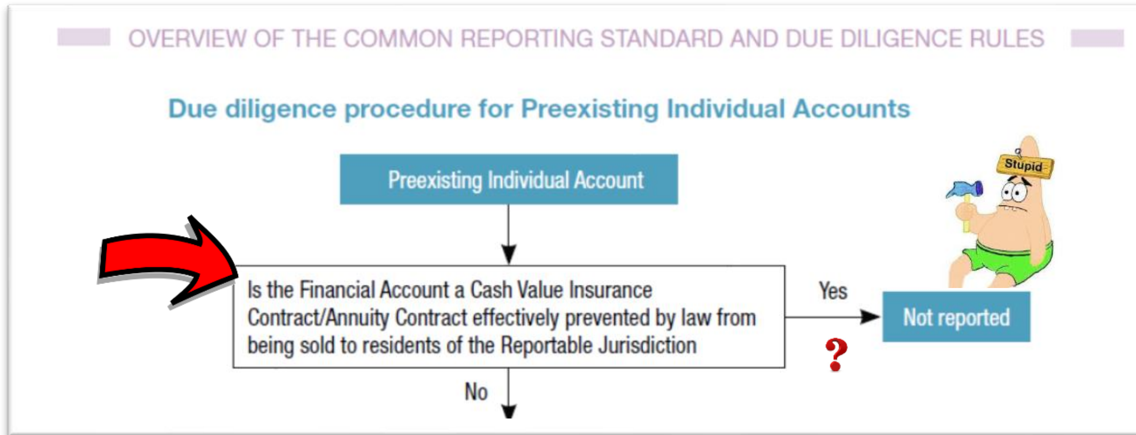
Many clients of trusts that hold untaxed Active NFEs ask their trustees if there is a way that will not report a distribution to the the beneficial owners of the trust.

Trustees then, to help their clients circumvent the CRS, purposefully misinterpret Commentary page 162 par(19) which states "The term "Investment Entity", does not include an Entity that is an Active NFE because it meets any of the criteria in D(9)(d) (i.e. holding NFEs.

These trustees then categorise the trust as an Active NFE holding type and do not report on the controlling persons.

This is wrong. The trust is an investment entity if it is managed by a corporate trustee and earns dividends from underlying companies. This will be covered in upcoming issue in retail.

The dumbest CRS loophole: Prohibited pre-existing Insurance



Exempting insurance prevented by law from being sold in a jurisdiction is the exact same mistake made by EU Commission in the EU Savings Tax Directive which exempted non-UCITS because it was not allowed to be sold cross-border

Accounts not required to be reviewed, identified or reported

CRS Commentary page 110 par(2) - All Pre-existing Individual Accounts that are Cash Value Insurance Contracts and Annuity Contracts are exempted from review, provided that the Reporting Financial Institution is effectively prevented by law from selling such contracts to residents of a Reportable Jurisdiction.

Effectively prevented by law definition

A Reporting Financial Institution is "effectively prevented by law" from selling Cash Value Insurance Contracts or Annuity Contracts to residents of a Reportable Jurisdiction if:

a) the law of the Reporting Financial Institution's jurisdiction prohibits or otherwise effectively prevents the sale of such contracts to residents in another jurisdiction; or
b) the law of a Reportable Jurisdiction prohibits or otherwise effectively prevents the Reporting Financial Institution from selling such contracts to residents of such Reportable Jurisdiction.

Where the applicable law does not prohibit Reporting Financial Institutions from selling insurance or annuity contracts outright, but requires them to fulfil certain conditions prior to being able to sell such contracts to residents of the Reportable Jurisdiction (such as obtaining a license and registering the contracts), a Reporting Financial Institution that has not fulfilled the required conditions under the applicable law will be considered to be "effectively prevented by law" from selling such contracts to residents of such Reportable Jurisdiction"

Simple examples will demonstrate the absurdity and sheer lunacy of excluding pre-existing insurance policies from review and reporting.

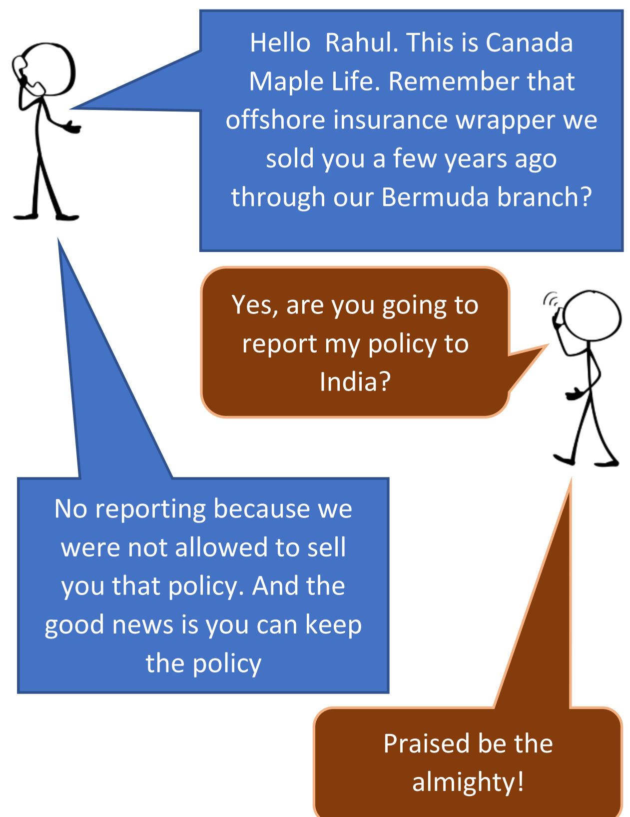
Example 1:

EU prohibits Andorra from selling policies within EU to EU residents. A Spanish tax resident drove to Andorra to places his Andorran bank account into an Andorran insurance wrapper in 2004 to avoid the EU savings tax Ludicrously, the no Andorran insurer must review the policy for CRS. An EU savings tax loophole lives on.

Example 2:

A Canadian global life insurer has through their Bermuda branch sold through the internet a cash value insurance wrapper to an Indian tax resident, even though India does not permit Bermuda to sell its residents insurance policies.

The Indian may maintain this policy and it will not be reportable under the CRS due to the insane exclusion of policies prohibited from being sold.



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next issue 07

Why look through non-reportable FIs that own passive NFE

What is the minimum threshold for FI managing assets to be Investment Entity

Is it possible to look-through a non-participating Custodial, Depositary or Insurance institution?

How is bank supposed to look-through a non-participating collective investment?

a sprinkling of topics in future issues…

FATCA reciprocal US territories

Can we ignore FAQ update until it is legislated?

Why an Active NFE is not a CRS solution

OECD addresses residence by investment and Citizenship by Investment