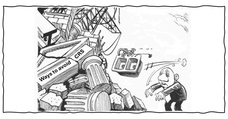

There are two strategies to hide clients from CRS: i) Use a fake weakness, or ii) Exploit a real loophole.

Mark Morris
CRS and CARF expert. No, truly.

July 16, 2024

I. Fake weaknesses

- It's astounding how many FIs misinterpret the CRS, incorrectly concluding it's a legitimate loophole.
- Either they think it's a non-reporting FI or the account is not reportable. The FI may be obtuse, but is more likely ignoring the OECD CRS updates and separate publications which tackle these weaknesses.
- For example, Swiss FIs accept UAE procured residences and when challenged, they indignantly retort that the authorities have not instructed them to follow the OECD initiatives on residence-by-investment or FAQ updates.

- **Mistaken jurisdiction of Investment Entity** - Many untaxed investment entities, other than trusts, mistakenly believe they are subject to the jurisdiction of its place of effective management. Thus, erroneously believing that they are located in the same jurisdiction as the equity interest account holders. If the director is the owner of his untaxed private investment company then he believes he does not report on himself as the FI and account holder are in same jurisdiction. The CRS actually states this type of untaxed FI is located where the share register is maintained which is a different location to place of management - see resolving dual residence of untaxed FIs.

- **Fake residence-by-investment** - Virtually no FI has bothered to reapply an enhanced review of clients' due diligence who presented a residence from the OECD list of high-risk residence-by-investment jurisdictions. Banks still accept, say, UAE or Malta residence without checking number of days actually stayed or centre of vital interest. Worse, OECD removed some countries off the list such as Panama and Monaco, enabling the con to continue. No jurisdiction outside EU has adopted the OECD anti-residence-by-investment to avoid CRS initiative. A herculean waste of effort by the OECD! Instead of CRS relying on utility bill and residence identity, just simply require tax residence certificate.

- **Broad participation retirement plan** : Pension providers in Hong Kong offering segregated funds were knocked on the head by the OECD's FAQ update regarding the 5% rule. However, there are FIs in other countries who continue to exploit segregated funds aggregated into an umbrella fund, to incorrectly claim qualification as a non-reporting FI.
- Gibraltar authorities are fast asleep allowing these types of trustee pensions to exist. Variations of the compartmentalized funds to avoid the CRS are still sold by managers in Switzerland, Curacao and Mauritius.

- **Zero cash value policies:** It's still bonkers that insurers in Luxembourg and Liechtenstein are incorrectly reporting (a null cash value or not reporting at all) on zero cash value policies, also known as irrevocable policies. Caribbean insurers offer a variant - frozen cash value and then report the faux capped cash value. These insurers ignore or misunderstand the OECD FAQ update. Additionally, some insurers believe protected or incorporated cells are not reportable.

- **Incorrect trading Active NFE**: The OECD FAQ update clarifies that any cash held, no matter its purpose or source (e.g. to buy stock or for operational expenses) must be regarded as held for the purpose to produce passive income. However, virtually every bank still incorrectly categorises their business clients as an Active NFE, ignoring the asset test. These should be Passive NFEs but what the heck.

- **Incorrect holding Active NFE:** Thousands of trusts in BVI incorrectly categorise themselves as non-reporting holding Active NFEs if they own a trading Active NFE. Ironically, most of the subsidiaries should probably be Passive NFEs - see previous point. Sure, these trusts are holding Active NFE for FATCA but are reporting FI Investment Entities for CRS. Unlike FATCA, the CRS defines only NFEs as being exempt from an Investment Entity, whereas FATCA regulations exempt **any** holding entity from being an Investment Entity.
- And what are the BVI authorities doing about this misinterpreted exploitation? *ZZZZzzzzz.*

- **Fake surety bonds:** Insurers in Caribbean offer concocted illicit variations of surety bonds, and overwhelming the local authorities with hocus pocus that these are not cash value policies. The authorities don't understand the smoke & mirror justifications provided by the insurers.

- **Welfare, disability and Long Term Care policies**: Same fake scenario as surety bonds. In fact, same insurers involved with this scam.

- **Company limited by guarantee:** Company with *no shareholders*. Stunning that FIs still believe a CLG has no controlling person. Hybrid versions in Turks and Caico with one shareholder is also being used to hide controlling persons. Ah ha... segeregated cell structures, such as protected cells, are sometimes used to also claim no controlling persons.

- **Nominees:** Yep folks, the 1980's style use of nominees still continues despite the CRS mentioning 3 times that the FI must determine the ultimate beneficial owner for whom the nominee is holding the assets. Bear in mind, a virtual click of the mouse, and one can transform a nominee into a non-participating Custodial Institution.

II. Use loopholes not closed by the OECD

A CRS loophole is an unintended exemption or exclusion. This would be a non-reporting FI or a non-reportable financial account or non reportable account holder. The OECD expedited a copy & paste version of FATCA, resulting in FATCA's weaknesses being embeded into the CRS. Now it will take years to weed out these structural flaws from the CRS. The OECD relying on the Mandatatory Disclosure Rules to tackle loopholes will be ineffective as it is not widely implemented, and those involved in avoiding CRS will certainly not self report.

- **Broad participation retirement funds**: As long as the retirement plan qualifies for one of the four conditions to be a non reporting FI.

- **Listed entities**: The OECD made an unforgivable amateurish error when it is **accepted** that a Reporting Financial Institution will not be able to determine the Controlling Persons for CRS purposes of listed*". The FATF Recommendations do not require the determination of beneficial ownership if an Entity is (or is a majority owned subsidiary of) a company that is listed on a stock exchange and is subject to market regulation and to **disclosure requirements (either by stock exchange rules or through law or enforceable means)** to ensure adequate transparency of beneficial ownership. This means the FI can determine the controlling persons, i.e. significant owner of listed shares. It costs a mere USD 30,000 to list your private company on a small stock exchange such as Curacao and hide your investments and cash holdings. Remember, the listed entity need not be regularly traded to exploit this loophole.

Curacao is a popular den of thieves listing exchange to IPO crappy Chinese companies with the sole purpose to avoid CRS

- **Personally listed ETFs**: Read "Is a personal listed ETF a valid CRS avoidance solution or a major misunderstanding by schmucks and ignorant tools?". ETFs do not qualify as a regularly traded entity as at least 10% of shares must be sol dto third parties annually. That won't happen with a personal ETF.

- **Related entities of listed** : The OECD was again naive to allow "under common management as a regularly traded Active NFE". Tax evading client sets up holding company **A** which buys 50% of company **B**, a regularly traded entity on a secondry exchange. This can cost as little as a villa. Company **A** also sets up subsidiary **C** which has a huge investment portfolio with private bank. Company **A** controls both its subsidiaries **B** and **C** through voting rights. Now get this, although company **C** has absolutely nothing to do with listed entity **B**, it is a related entity of **B** because it's under common control of **A.** How ludicrous, ridiculous, crazy, abulvie is that? C'est la vie, portfolio company **C** is legally exempt from the CRS reporting because it's related to a regularly traded entity. It is my supposition that the OECD envisaged related entities of listed entities were a solely the parent or subsidiary when granting Active NFE status. No way did they consider a sister of a regularly traded entity.

- **Cash value not permitted**: Imbecilic exemption by OECD for pre-existing policies that were provided despite being prevented by law from being sold to residents of a country: Duh, Andorran insurers ecstatic.

- **Controlling person threshold:** The 25% threshold is too easy to manipulate so that there is no reportable controlling person.

- **Convert Passive NFE into Active NFE**: This loophole shows why there should be no such category as Holding Active NFE. To escape reporting the Controlling Persons, ***Entity A*** establish a new parent Entity B which own 100% of subsidiary ***Entity A***. Parent Entity B strips subsidiary ***Entity A*** of all its cash by means of loans and dividends, i.e. subsidiary ***Entity A*** loans all its excess cash to its parent Entity B. Future dividends can offset these loans. Subsidiary **Entity A** should own non-financial assets such as computers, vehicles, furniture, IP, etc. Subsidiary ***Entity A*** ensures its non-financial assets are worth more than the retained cash. The CRS does not describe if the asset test for Active NFE type A is annually, quarterly, average over the year, etc. As subsidiary **Entity A's** income is mostly passive and most of its assets cannot produce Financial Income, then subsidiary ***Entity A*** will qualify as an Active NFE type A (business or trade). The second part of the alchemy process is where parent Entity B can be elect to be categorized as an Active NFE type D Holding because more than 80% of its activities consists (income or value) of holding subsidiaries engaged in business or trade. Astoundingly, countries like Liechtenstein define a subsidiary in this particular context as holding 10% or even less (enabling easy qualification of Active NFE) whereas rest of the world generally follows IFRS standard that a subsidiary is at least 50%ownership.

- **Report nil value for Zero Cash Value**: Swiss, Liechtenstein, Luxembourg insurers still continue to report a nil value, by perverting the understanding of surrender value and surrender fees. For an insurance policy where policyholder has voluntarily surrendered his rights to access the policy assets, despite a high chance that the policy premium were undeclared assets.

- **Report Nil value for settlors of Investment Entity irrevocable trusts:** You can thank Singapore, Liechtenstein and Cyprus for guiding a non sensical nil value for the value of undeclared illicit assets contributed to an irrevocable trust, despite half the world not recognising a trust or wanting to impose gift tax on setting up irrevocable trust.

Wealth managers managing assets held by non-participating FIs: Many CRS wealth managers blatantly advertise on their website that the assets are custodied with US banks such a Pershing for security... and here is the OECD reaction to assets being moved to the USA...

- **Trusts USA** - Global trust companies based in the CRS jurisdictions decided it was a good tactic to set up trusts in the USA and have the clients "request" that he trust be moved, lock stock and two smoking barrels to the USA. Nudge, nudge, wink, wink, legitimate tax planning for US emigration by descendents is the common retort.
- **Others** - There are many other fake or misunderstood weaknesses caused by the FIs not understanding the CRS or ignoring the FAQ updates. There are also other real flaws in the CRS. This article just gives a flavour. It will be up to the OECD to peer review these jurisdiction's application of the CRS, which should take a century or two.

Non-participating Custodial Institution: There is no look through of non participating Custodial Institutions. A trust can be a SPV custodial institution .

Summary

- No matter what the OECD does, there will always be loophole that cannot be closed.
- Mandatory Disclosure Rule for CRS avoidance arrangements is a lazy initiative to tackle all the outstanding CRS loopholes.
- The MDR is not being adopted by hardly any jurisdictions.
- As long as the CRS is not implemented in every country, the use of a Depositary Institution, Custodial Institution or Insurer subject to the jurisdiction of a non-participating jurisdiction that maintains the financial assets in a CRS jurisdiction would escape both CRS and FATCA's promised equivalent reciprocal reporting.

==========**END**==========

Mark Morris
CRS and CARF expert. No, truly.

Comments

Griffin Smith and 1 other

Like
Comment
Share

Add a comment...

No comments, yet.
Be the first to comment.

Start the conversation

More articles for you

Financial Advisors: SMSF's and Superannuation Death benefit tax option
Phillip Davey
1

The Weekly Wealth Recap
Jonathon Bithell ACSI
22 · 2 comments · 1 repost

Does the QAR put advisers and super funds at odds?
Level up your efficiency
4 · 1 repost