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Seeking Security in a Transparent World: Understanding FATCA & CRS Compliance

Mark Leeds
Partner, Mayer Brown (New York)
mleeds@mayerbrown.com
(212) 506-2499

Benjamin Homo
Partner, Mayer Brown (Paris)
bhomo@mayerbrown.com
33 1 53 53 434 43

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Mark H Leeds (212) 506-2499 (mleeds@mayerbrown.com) is a tax partner at the law firm of Mayer Brown. Mark's professional practice focuses on the tax consequences of a variety of capital markets products and strategies, including over-the-counter derivative transactions, swaps, tax-exempt derivatives and working with US individuals and family offices. Mark is a frequent writer on tax issues presented by wealth management. Prior to joining Mayer Brown, Mark was a partner at another International law firm, served as a Managing Director at Deutsche Bank, general counsel of a credit derivative company and, prior to that, Mark was a partner at Deloitte, where he led the Capital Markets Tax Practice.

Benjamin Homo

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Benjamin Homo (+33 1 53 53 43 43 (bhomo@mayerbrown.com) is a tax partner in the Paris office of Mayer Brown. He focuses his practice on advising private equity clients and multinational groups on their acquisitions, mergers and reorganizations and has developed an extensive experience of multi-country transactions. He also advises on the creation of French and pan-European private equity funds and assists corporate groups in the day-to-day management of their tax affairs (tax audit/litigation, reporting tools) as well as high net worth individuals and managers on their personal tax issues. Prior to joining Mayer Brown, Benjamin was a tax lawyer at Arthur Andersen International and Ernst & Young.

FATCA & CRS Background

Statutory Overview of FATCA

- **FATCA (Foreign Account Tax Compliance Act) became law in March 2010. President Trump may alter or repeal law.**
 - **Addresses US tax non-compliance by providing transparency with respect to assets and investments held outside of the US by US persons**
 - **Intended to provide increased reporting, not collect tax, but the “hammer” is a 30% withholding tax imposed on non-US financial institutions**
 - **Requires non-US Financial Institutions to provide information on specified US owners to the Internal Revenue Service or to the taxing authorities in the country in which the non-US entity is resident.**

Income Potentially Subject to FATCA Withholding

- Only “withholdable payments” are potentially subject to 30% FATCA withholding.
- Withholdable payments include US-source interest, dividends, royalties and other forms of FDAP (fixed determinable & periodic income)
- Beginning in 2019, withholding will be required on gross proceeds from the sale of property that gives rise to US-source interest & dividends
- Exemption for certain non-financial income, such as nonfinancial goods and services
- Pass-through payment rules are to-be-specified
- Refund available for non-FIs if a treaty applies.

Intergovernmental Agreement Overview

IGAs are treaties between the US and other countries under which the non-US country agrees to prescribe rules for its financial institutions to conduct due diligence & report on US and US-controlled accounts.

There are 2 types of IGSs: Model 1 and Model 2.

When a non-US country signs an IGA (or agrees to sign an IGA), the US FATCA regulations do not apply to financial institutions located in that country.

Instead, the non-IGA country specifies its own due diligence rules for its financial institutions to find and report on US accounts.

In a Model 1 IGA country, local financial institutions report on US accounts directly to the local tax authority (who reports to the IRS).

In a Model 2 IGA country, local financial institutions report US accounts directly to the US Internal Revenue Service.

No withholding is generally required on payments to FIs in countries with a signed IGA unless the IRS has identified the FI as non-compliant.

The Common Reporting Standard (CRS) and Trusts

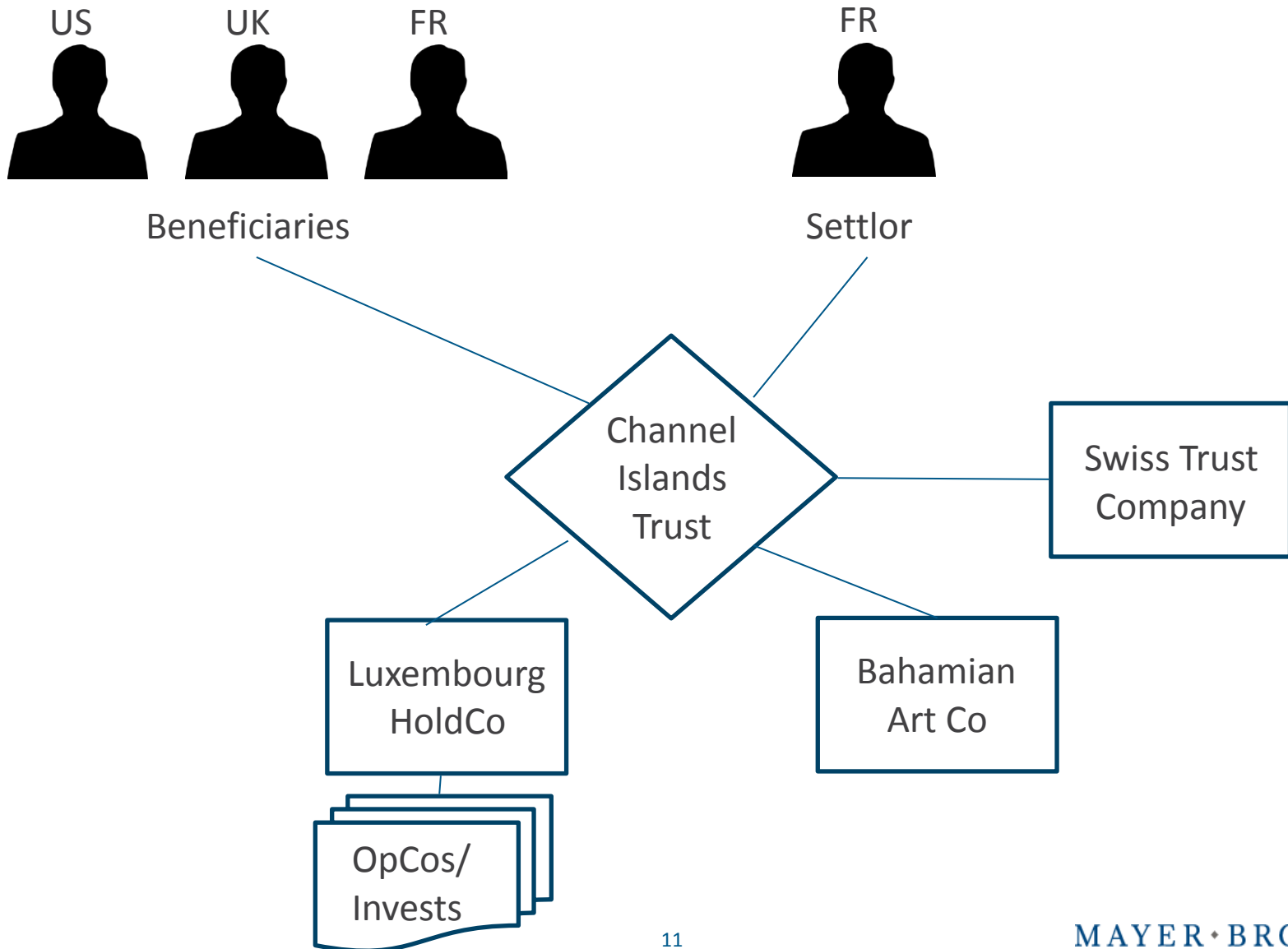
CRS Compared to FATCA

	FATCA	CRS
De minimis limits	\$50,000/\$250,000	No de minimis (with the exception of preexisting entities with a value lower than \$250,000)
“Reasonableness” of tax forms	Focused on US person status	Focused on tax residency
Who is an FI?	Most financial institutions unless specifically exempted as being low risk	FATCA exemption removed – flexibility for local guidance to define specific exemptions for low risk entities
Reporting	Primarily to the US (other than Model 1 jurisdictions)	Bilateral exchange via local adopter jurisdiction

CRS Compared to FATCA

- No withholding under CRS
- No phased implementation of reporting
- Multiple reporting is possible
- No EAG concept
- No registration
- A managed investment entity in a non-participating jurisdiction is treated as a passive NFE (i.e., look through the entity to controlling persons)
- International law versus unilateral approach

Case Study: The Typical Family Trust Structure



The CRS Reporting Parameters

Where is the Trust resident?

Who has the reporting obligation?

Who needs to be reported?

What needs to be reported?

Basics on Trust Reporting

If the Trust is a passive non-financial entity (NFE), the underlying banks and other Account providers are required to report on the controlling person and the trust accounts maintained by that person.

The FI must report the account balance and the gross payments & credits.

The FI must also report on all controlling person (settlor, beneficiary, trust protector and/or trustee).

Discretionary beneficiary reporting

This is separate from the specific reporting obligations that may already exist for trust administrators (in France, annual obligations to report on any trust in which settlor, beneficiaries or assets are French)

CRS Trust Residency Analysis

A trust is considered to be resident for CRS reporting in the jurisdiction in which the trustees are resident.

If, however, the trust is treated as an FI resident in another participating CRS jurisdiction, no reporting is required in the residence of the trustee.

How to identify where a trust is resident for CRS purposes:

1. Is the trust treated as a tax resident of a CRS participating jurisdiction?
2. Is the trustee resident in a CRS participating jurisdiction?
3. Issue of several trustees: The Trust may be treated as resident in more than one jurisdiction and multiple reporting may be required.

Who is Required to Report on the Trust?

Only Financial Institutions (FIs) are required to report.

If the trust is not treated as a FI, it will not have reporting obligations. If an individual is the trustee, the trust should not have CRS reporting obligations.

If the trust is a treated as an FI, no reporting is required if:

1. The trust is a non-reporting FI & the trustee is a reporting FI and the trustee undertakes all information reporting in respect of all reportable accounts of the trust.
2. The trust is treated as resident in a non-participating CRS jurisdiction. This requires that both of the trust and the trustees be resident in non-participating CRS jurisdictions.

Domestic reporting obligation: France example

Before 2011, the concept of “trust” was unknown in French tax law leading in practice to massive avoidance for PIT and Fortune tax purposes.

Due to both an increasing transparency climate and emblematic cases like *Wildenstein*, a reporting obligation has been implemented together with a comprehensive tax regime.

The reporting obligation is divided in both an annual filing obligation and a specific filing obligation.

Trusts required to report: Trusts where the settler and/or the beneficiaries and /or the administrator is/are resident(s) for French tax purposes or trusts owning assets or rights located in France.

Person required to report: The administrator

Information Reporting Pitfalls

Over-reporting is a practical pitfall:

1. When multiple parties have reporting obligations,
2. Due to reporting to multiple tax authorities
3. Reporting the full value of trust assets to each beneficiary. This rule can cause each beneficiary to appear to have more assets than is actually the case.

Mistakes in Reporting may be difficult to rectify with tax authorities.

Confidentiality. If a beneficiary has not been informed of his/her status as a beneficiary, the tax authorities may still contact that beneficiary.

Appoint a reporting agent/coordinator.

Domestic reporting obligation: France example

Content of the reporting obligation

- **The annual filing** is made each year by the administrator and mostly describes the content of the trust and the actual value of its worldwide assets should the settler and/or the beneficiaries be French residents (limited to the French assets otherwise)
- **The specific filing** is made whenever the trust is modified (creation, change in beneficiaries, in the terms of the trusts, disposal or transmission of an asset, extinction, etc.)

Destination of these filings: A register accessible to the FTA, customs, public prosecutors, anti-laundering department, etc.

Sanctions: Fixed fine of 20k€ + application of an 80% penalty on taxes corresponding to undeclared assets in case of a reassessment

Reporting on FI Trusts

Settlor - Total Value of Trust property and value of payments made to settlor in reporting period.

Mandatory Beneficiary - Total Value of Trust property and value of payments made to beneficiary in reporting period.

Discretionary Beneficiary - Value of Trust property is *not* reported but value of distributions made in reporting period is reported.

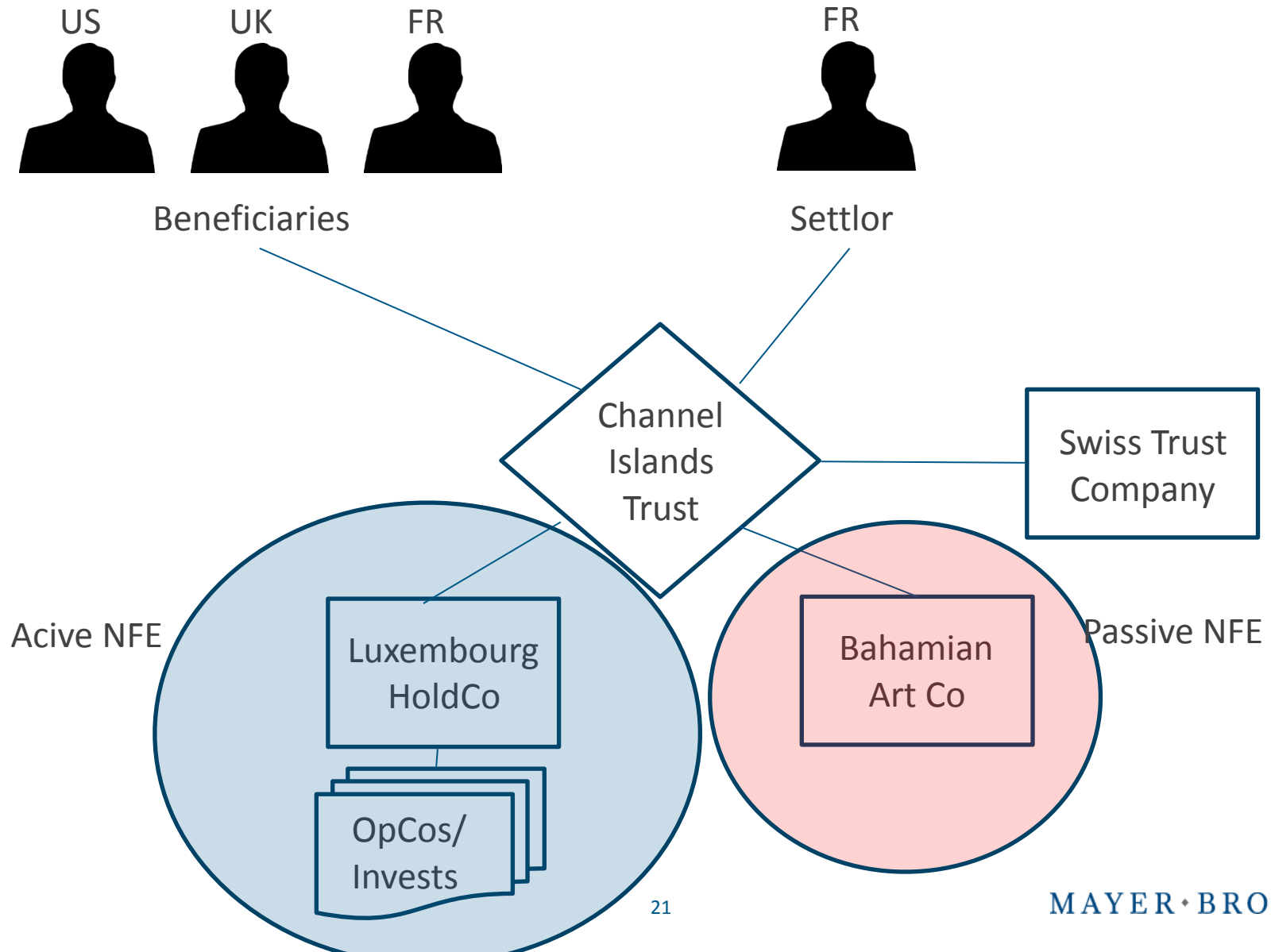
Persons exercising effective control - Total Value of Trust property is reported and value of payments made to person in reporting period.

Lender to Trust - Principal amount of the loan and value of payments made to lender in reporting period.

Approaching CRS Reporting

1. Ask if the Trust is an FI. If it is at all, it should fall under the category of investment entity. Institutional trustee is required.
- 2a. If the trust is an NFE, is an active NFE? If so, no reporting will be required.
- 2b. If the trust is a passive NFE, then the trust's account providers must report account information on each controlling person resident in a CRS jurisdiction.
3. If the trust is a FI, is it resident in a participating jurisdiction? If not, then the trust's account providers must report account information on each controlling person resident in a CRS jurisdiction.
4. Is the trust is a FI & resident in a participating jurisdiction, then does the trustee or another person have the reporting obligation?

Case Study: The Typical Family Trust Structure



Practical Issues in CRS Reporting

Issues to be Addressed:

- (Tax) Residency of the Trust
- CRS residence of the Trustees
- CRS residence of banks.
- Are the trust assets passive or active?
- Ensure coordination between banks and trustees to have consistent reporting

Multiple Reporting Issues

- Number of Trustees
- Understand reporting requirements before formation
- Organize communication among the parties

Controlling the flow of information

- Consider forming Trust to Be an FI/FFI – you get to tailor and choose how information is presented
 - Costs can be worth it
 - Can the banks refuse to recognise your FI/FFI status and report themselves?
- Try to aim the reporting to few people as possible
 - Settlers/founders (unless dead or in a non-participating jurisdiction) are always going to get reported
 - Discretionary beneficiaries not receiving distributions are (for now) not reported
 - Those with less than a 25% beneficial interest are not reported – yet
- Protectors and power holders
 - Consider jurisdiction of residency
 - Where there are multiple trust protectors, consider entities that may not cause the individuals to be reported
- With beneficiaries across multiple jurisdictions, consider separate structures tailored to each jurisdiction
- Loans?
- Non-reportable asset classes?

Avoiding an Audit on CRS Compliance

- **Align the reporting with the home country tax treatment**
 - **Make sure the CRS reporting points at the correct reportable person**
 - **Are settlors/grantors/ founders or beneficiaries or the trustees / underlying entities taxable?**
 - **Are parents assessed on a minor child's income and gains in the home jurisdiction?**
- **Try to make the structure look onshore or in jurisdictions less likely to arouse suspicion**
- **Keep it simple – complexity will just attract attention because tax authorities won't understand**
- **Consider what other information the tax authority has access to and that it can compare**