[1]STEP HK

SUBMISSION TO THE

LEGISLATIVE COUNCIL BILLS COMMITTEE

ON THE INLAND REVENUE (AMENDMENT) BILL 2016

A. Background

1. STEP (see www.step.org) is the peak global representative body of 20,000 individuals who advise families on passing wealth across the generations. We regard the issue of the confidentiality of personal financial information of the families our members represent as firmly within our remit. We have no corporate members although many of our members work for corporates. We do not represent banks or other institutions. We regularly make submissions regarding government initiatives around the world and made representations and submissions to the OECD in the formulation of CRS. STEP unequivocally opposes tax evasion (the deliberate non-disclosure of reportable tax information or the deliberate presentation of false or misleading reportable tax information) everywhere. STEP also fully recognises that the globalization of capital / income flows demands appropriate international cooperation by governments everywhere to make sure relevant information is available to them to raise taxes in accordance with their laws. This submission is made by the HK branch of STEP.

2. It is in the architecture of international tax information cooperation agreements where government's rights to access reportable tax information conflict with the rights of individuals to appropriate protections to their privacy rights to ensure that their personal information is not abused to their detriment. Ultimately, it is a

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question of whether these new government rights to tax information via its automatic exchange (i.e. CRS) are justified in the circumstances.

3. STEP submits that for the following reasons CRS as proposed for Hong Kong ("HK") in the IRO Amendment Bill 2016 ("the Bill") before this Council is simply not justified. However, STEP believes that with some straightforward changes, as outlined below, it can be so justified.

4. This submission will use terms and abbreviations used in the FSTB's Consultation Paper on AEOI.

B. The Problems With CRS As Proposed

The nature and extent of the reportable information

5. CRS (as regards HK) would see the collection, aggregation, storage and exchange (annually, automatically) of very detailed financial information of HK taxpayers who bank / invest abroad and anyone who banks / invests in here with residence status in a relevant jurisdiction This information would consist of end-of-the-year balance of all reportable accounts (mostly only with year end balances of more than USD250, 000) and the dividends/ interest and other income and gains generated annually by those accounts.

6. Where the account is held other than by an individual (companies, funds, trusts, partnerships and other entities) the rules would see through the relevant entities to their ultimate owners / controllers and, if they are residents in a country with whom HK has a CRS agreement, those ownership details would also be collected, stored and exchanged in addition to the underlying financial data.

7. This highly sensitive and detailed information relating to HK taxpayers who bank / invest abroad is not necessary for the IRD to raise taxes because HK does not tax the foreign-sourced income of its taxpayers. In fact, the IRD is not for that reason, as a general matter, currently empowered under domestic law to demand that

information from HK taxpayers. But CRS would see that information in the IRD's hands through the backdoor of our CRS partners giving it to them. And this would be done without any notice to our taxpayers.

Dangers of loss or abuse of that information

8. This detailed information of HK people is currently not gathered or aggregated by foreign financial institutions or foreign governments in the way CRS would see it done. Most places do not tax foreigners on these types of investments so, whilst the information is, in some form, in the hands of the FI's, it is not now aggregated and given to the tax authorities automatically. CRS would, in fact, provide to the individual foreign tax authorities an aggregated / consolidated profit and loss account of all reportable investment holdings of each Hong Kong person held in that jurisdiction. It would also provide to the IRD that same information but consolidated on a global basis so that the IRD would see each year a full picture of all HK resident's investment/bank accounts held across all CRS partner jurisdictions. Never before would HK people have had so much of their sensitive data gathered, aggregated and sent to the IRD (or indeed anywhere else) without them even knowing what that data was thus denying them the opportunity to correct any incorrect information.

9. This information in the wrong hands (of which there is no shortage) will expose our citizens to a range of negative impacts ranging from mere embarrassment, to identity and property theft, blackmail, extortion and, worst of all, the kidnapping of their children.

10. With the best will in the world, this detailed financial information is simply not capable of being adequately protected. Historical experience shows that the accessible nature of digitized information and the frailties of the human condition together guarantee that indeterminable amounts of this data will be lost or abused by one or more of its gatherers, storers or exchangers. Nothing in this world is surer. HK has of course had its own recent experience with the VTech scandal. In 2015, the

US alone witnessed 781 major data breaches as tracked by the Identity Theft Resource Centre (http://www.idtheftcenter.org/images/breach/DataBreachReports_2015.pdf). In 2015, 71 breaches of records were recorded by the banking financial service industry, 312 by business, 63 by government and 277 by medical / healthcare businesses. Almost every American was affected by at least one data breach in 2015. As recently as February 9th 2016, the IRS disclosed a recent attack on its Electronic Filing PIN application program (on irs.gov) perpetrated by cyber criminals in which a malicious bot used 101,000 Social Security Numbers to successfully access PINs. And all this happened in the country which arguably has the world's most sophisticated data protection system and the most effective sanctions for loss of data. See also www.informationisbeautiful.net/visualizations/worlds-biggest-data-breaches.

11. It is impossible to have confidence that this, or worse, will not happen in many of the countries which are on the potential list for HK to exchange data with. It is one thing to have faith in one's own government to keep tax information safe; it is quite another to extend that faith to possibly one hundred other countries, many of which have unstable political systems, questionable judicial systems and lamentable human rights records i.e., they lack the basic governance systems necessary to keep this information safe.

12. As far as the many thousands of foreigners who bank / invest in HK (the world's third most important financial centre) CRS will provide to our CRS partners (via the IRD) similar levels of sensitive financial information. The risk of that information being lost by or stolen from our financial institutions, the IRD, or the foreign governments once they get it, cannot be under-estimated. CRS as proposed offers little or no real meaningful protection of this information; nor could it in reality. CRS contains no meaningful sanctions for those who lose or abuse the information.

The necessity of CRS as proposed

13. Whilst STEP recognises in para 1 above the necessity of international cooperation in gathering the tax information of citizens everywhere, we question whether CRS as proposed is really necessary (see further below at paras 17 &18). This is because the OECD and the governments represented by it have already all but won the war on cross-border tax cheating. A raft of new tax information exchange treaties (HK has 34 CDTA's and 7 TIEA's all on request - not automatic) the criminalisation of helping tax cheats in any way and the opprobrium and fines heaped on financial institutions caught at this game (think UBS, Credit Suisse, HSBC and many others) has completely and rightly made tax cheating toxic for all concerned. There are no "weapons of tax destruction" out there anywhere, anymore. There remains a toxic legacy of old tax-cheating money which is being cleaned up by tax amnesties. This process will be much assisted by a CRS modified as we suggest below (see para 18). CRS can therefore be seen as taking a sledgehammer to an already cracked nut.

The American Loophole

14. Finally, there is a gaping loophole in CRS- the largest financial system in the world, the USA. If non-US taxpayers choose to put their offshore funds into US entities which bank with US located banks (this can be done without attracting US taxes) there will be no CRS reporting because the US refuses to sign up to CRS. One reason is that the US has its own global (essentially non-reciprocal) system for tracking down its citizens who try to cheat US taxes by putting their assets abroad, namely, FATCA. See the attached recent article in The Economist which deals with this very issue. Another reason is the lack of political will in the US to allow CRS type information to be sent automatically from the US to places like China, Russia and Mexico. It is also of interest that Taiwan has not signed up to CRS.

15. This will inevitably mean sensible non-resident customers of our FI's (and those everywhere) will look very closely at moving their business to the US, as will locals who now bank abroad. The USA is already the biggest depository of offshore money in the world (both tax compliant and otherwise) and it stands to benefit hugely by being the most important finance centre not to sign up to CRS.

C. Summary

16. In summary, CRS as proposed will see HK actively participate in a global exercise in mass-surveillance of the sensitive financial information of hundreds of thousands of innocent people around the world with all the negative consequences (both intended and unintended) that will inevitably flow from this. This is so even though HK does not require the reportable information on our own taxpayers; when there are no meaningful ways to protect the gathered and exchanged data nor sanctions for its loss or abuse; when the necessity of CRS at this stage of the war on tax cheats is questionable; when the costs of implementing CRS regulations (which will be very significant) will undoubtedly be passed onto customers; when it will potentially severely damage our attractiveness as an international finance centre; and when there is the massive US loophole in CRS.

D. What LEGCO Can and Should Do

17. If HK chooses not to require our CRS partners and their financial institutions to gather and provide the reportable information to the IRD on our own taxpayers, the potential dangers to HK citizens will be much reduced. Our CRS partners should have no argument with this. HK chose the non-reciprocal path with FATCA and there is no reason why it could not do so with CRS. Paragraph 2.35 of the FSTB's Consultation Paper foresees that the IRD will exchange data that will "only involve those persons who may be subject to taxation in their home jurisdictions". HK residents are not subject to tax here on offshore investment income so it should be a simple matter for HK to ask its CRS partners to act the same way to towards HK taxpayers. In fact we submit that HK should go further and ensure that our CAA's with CRS partners do not require their FI's to collect data on HK residents and send it to their tax authorities. There is simply no reason why HK should unnecessarily expose its citizens to the real risks of loss of this sensitive data by creating unnecessary pools of it.

18. On HK's side we submit that it should restrict the information of non-residents it forces FI's here to gather and report to the IRD and exchange with our CRS partners ***to the fact that a resident of country A has a reportable account here***. If HK did this the following would result. Taxpayers around the world would be on notice that their tax authorities know that they maintain reportable accounts here. This would act as a powerful incentive to the remaining non-compliant foreigners who bank/invest here to come clean with their governments or go elsewhere and to discourage new account holders from seeking to use HK to cheat on their home taxes. In addition, foreign tax authorities would have the information necessary to use the existing exchange of information provisions to request greater detail if they needed to. This is a positive development which would breathe new life into the existing exchange of tax information treaty network. And this would be done without having the detailed financial records of many thousands of innocents career round the ether unchecked and at the mercy of those with bad intentions. These on-request information flows would at least be targeted at those with questions to answer and be capable of being properly monitored.

19. These suggested changes, it must be said, are unlikely to be greeted with much enthusiasm by the OECD and some CRS partners because many of them have already (see para 20 below) passed their own implementing regulations. They would fear, rightly, that they might lose business to HK because it would be seen, not as a place to cheat taxes, but as a responsible international finance centre that had a genuine interest in the privacy rights and welfare of those who choose to bank/invest there. There is mention in the FSTB's Consultation Paper that HK wishes to avoid being labelled as an "uncooperative" jurisdiction and that is surely the desired outcome. If HK genuinely embraces the spirit of CRS (but not necessarily every detail of the 100 pages of the Bill as prescribed by the OECD) and were the subject of criticism or worse, the threat of sanctions, the question of who actually exercises sovereignty over HK's tax laws would be bought into sharp relief. It should also be remembered that the HK Government has made it very clear to potential CRS

partners that its agreement to participate in CRS as proposed was wholly conditional on getting Legco approval of the Bill now before this Council.

20. STEP submits that this Council, by adopting the changes proposed above, can sensibly mitigate the inherent dangers of CRS as proposed and limit the damage to our reputation as a responsible international finance centre without HK abrogating its international responsibilities to assist foreign governments in the on-going war on tax cheats.

21. This Council, unlike many other CRS jurisdictions who have already passed the implementing regulations via bureaucratic diktat, retains genuine legislative sovereignty over this critical matter. We urge this Council to exercise its powers in the overall interests of Hong Kong and its people.

E. Technical Amendments

22. There are numerous technical issues with the legislation (most of which are summarised in the attached STEP CRS Guidance Note) on which we wish to reserve our right to comment. However, we think the majority of these will fall away if the changes we recommend are adopted.

William Ahern

For and on behalf of the STEP HK Legislative Committee

Hong Kong February 23rd 2016

STEP Guidance Note: Common Reporting Standard

INTRODUCTORY NOTE

Dear Member,

As you will be aware, the OECD released a helpful CRS implementation handbook in August 2015, designed to assist government officials in the implementation of the CRS. It provides guidance on the application of CRS generally with some detailed commentary with specific reference to trusts.

We took the opportunity of meeting the OECD Secretariat team responsible for the guidance in order to clarify a number of points of information. As a result, we prepared our own summary of our dialogue with the OECD Secretariat. While this cannot be viewed as official OECD guidance (and we understand there will be future answers to FAQs and updates to the Handbook) we nevertheless thought it would be helpful to you if we shared our notes of the discussions we have had.

Please note that there are some open questions that the OECD is considering, namely in the context of points raised at sections 12, 13 and 15. We will continue to engage with the OECD on these points.

We hope, in the meantime, that this will be of help to you in advising clients in this complex area.

Please let us know of any new points that may occur to you in your review of this matter that you would like us to raise in our ongoing dialogue with the OECD.

John Riches
Co-Chair Public Policy

George Hodgson
Deputy Chief Executive

CRS HANDBOOK – ISSUES DISCUSSED AT MEETING ON 1 OCTOBER 2015

(OECD Secretariat response in bold)

This note is intended to outline a number of key issues for discussion at our meeting in Paris on 1 October. We have raised issues by reference to the Paragraph number in the CRS handbook for ease of reference.

1. We note that in some cases in the guidance on FATCA and the UK intergovernmental agreements (IGAs), practical examples are used to illustrate key points. Is there an openness to consider this approach for the guidance, given some of the uncertainties that can arise?

   The OECD Secretariat said that in any area of uncertainty it would be possible for an FAQ to be suggested to the OECD Secretariat, who would consider whether to include it in the live list of FAQs.

2. **Paragraph 109 – time of identification of the Controlling Persons of an Entity**
   We note the requirement to follow FATF principles and essentially look through entities to their Controlling Persons. In many cases where trusts are established by individuals whose domestic law does not recognise trusts, the individual settlor may be advised to first transfer assets to a company that acts as the corporate settlor of the trust. For CRS purposes, in order to identify the individual who is the economic settlor of the trust, it is necessary to consider the ownership of the corporate entity and its 'Controlling Persons' *at the time assets are contributed to the trust* and not at the time that the report by the RFI is being prepared (where possibly ownership of the entity concerned may have changed or the entity may no longer exist).

   The OECD Secretariat confirmed that for pre-existing customers, the RFI can rely on what they hold on file for AML purposes. For new customers, if the RFI is relying on AML processes to identify the Controlling Persons, the AML processes must be consistent with the 2012 FATF Recommendations.

3. **Paragraph 182 – use of a service provider in another jurisdiction to assist with CRS compliance**

   We note that FAQ 14 at page 109 confirms that, where an RFI uses a service provider to oversee compliance with its CRS obligations, it is not necessary for that service provider to be located in the RFI's 'home' Reporting Jurisdiction provided the underlying data is available. It would be very helpful if this could be cross-referenced at Paragraph 182 to avoid confusion.

   The OECD Secretariat confirmed that this could be made clear in paragraph 182. The OECD Secretariat confirmed that there was no requirement for the third-party service provider to be in the same jurisdiction.

4. **Paragraph 196**

   In paragraph 196 there is reference to 'other similar legal arrangements'. It would be helpful to understand what is meant by this. It is not uncommon to set up partnerships as a vehicle for holding family wealth. For example: a grandfather contributes to a partnership for the primary benefit of his grandchildren. His son is appointed as general partner and controls the allocation of income and capital among the limited partners. The

grandfather is not a controlling person, but if this were a trust (which is not the case) he would be. Is there any intention to treat a family partnership such as this 'legal arrangement' similar to a trust?

The OECD Secretariat confirmed that in the example given the partnership would be treated as a partnership and not a 'legal arrangement' similar to a trust.

There was a discussion about different types of legal entity in a jurisdiction, which can have different characteristics depending on how it is structured and administered e.g. a stiftung or anstalt can have characteristics of both a trust or a company. The OECD Secretariat confirmed that each jurisdiction could identify how they would characterise entities in their jurisdiction for this purpose. However, as the standard requires jurisdictions to ensure effective implementation of the CRS, including anti-avoidance rules in respect of practices intended to circumvent the CRS, the abuse of different types of legal entity to avoid reporting may attract penalties. In addition, the OECD Secretariat and the Global Forum on Transparency and Exchange of Information will monitor the use and characterisation of different types of legal entity in the context of the CRS. Where necessary, the OECD Secretariat will make adjustments to the CRS, and/or the Global Forum will make recommendations to particular jurisdictions to amend their laws.

5. Paragraph 204 – protectors

We note the reference to the protector who '*enforces and monitors the trustees' actions'*. We think this statement is misleading as many protectors have a very passive role and are not in possession of information (and are not entitled to receive that information) about trust activity. This is a point we return to below in the context of reporting. It might help to add that a 'protector' may be given a wide range of powers.

- the protector may have veto powers over certain decisions of the trustees, e.g. powers to distribute capital but not income, or power to add or exclude beneficiaries, and may therefore be closely involved in decision making; or, for example
- the protector may simply have power to appoint and remove trustees and therefore is not closely involved in the general administration of the trust.

In the majority of cases, the protector is not a family member of the settlor nor is he intended to benefit from the trust (in many cases the protector is expressly excluded from benefiting from the trust). The protector therefore may have no control and no beneficial interest in the trust but merely hold certain powers which are largely passive and may never, in fact, be exercised. The protector will have no personal tax liability or tax reporting obligation with respect to the trust and the jurisdiction in which the protector is resident will have no taxing interest in the trust. On the basis that the exchange of information under CRS is intended to enable tax authorities to determine whether residents in their jurisdiction have a tax liability by reference to financial accounts they hold, it is difficult to see the justification for providing information about protectors with no control over and no financial interest in the trust.

In addition, given that many trusts have not just one protector but a number of protectors forming a committee, requiring information about the trust having to be provided to each jurisdiction where a protector is resident will require substantial disclosure to jurisdictions that have no taxing interest.

On this basis, we wonder whether the better solution would be to provide information only about protectors who are also beneficiaries of the trust.

The OECD Secretariat confirmed that they did not want to provide for a protector to be identified by reference to the powers held or whether or not the protector is a beneficiary. They noted that it is not possible to identify every power holder and that, following FATF guidance, it was necessary only to disclose information about the protector. If a person, not identified as the protector, has power over the trust this may mean that information about this person is not disclosed. However, if this resulted in people finding ways to get round the disclosure obligations, then the rules may be updated to include such other power holders. Where the RFI has information on what type of Controlling Person the account holder is (such as being a protector), this must be included in the report. Doing so will enable the tax administration receiving the information to make appropriate use of the information in tax compliance actions.

6. **Paragraph 205 – Trustees as Financial Institutions – application to 'private trust companies**'

    a. It is common practice for wealthy families setting up trusts to set up a company to act as trustee rather than to appoint trust companies owned and controlled by Regulated Trustee Service Providers. The majority of trust jurisdictions require trust companies to be licensed but have specific limited licensing rules or exemptions from licensing that apply to these companies. These tend to be known as 'private trust companies' or '**PTCs**'). In most cases, PTCs are administered and overseen by Regulated Trustee Service Providers who also provide senior personnel to serve as directors of the PTC, sometimes alongside family members or advisers. In some jurisdictions, PTCs are subject to optional licensing and regulation (for example, the Cayman Islands and South Dakota) and, in the majority of cases, are expressly supervised by a local regulator. The main difference from 'public' trust companies is that they are not authorised to take on trusts except for those relating to a particular family.

    b. There is a brief reference to PTCs at page 113 of the Handbook, confirming that certain activities undertaken by a PTC will not be regarded as amounting to 'management' in the context of what constitutes an 'Investment Entity'. We think it would be very helpful both to cross-reference paragraph 205 to this FAQ and state the positive position that where a PTC conducts significant investment oversight activities in a manner analogous to a 'public' trust company that it can be regarded as an Investment Entity and will thus be capable of being regarded as a Financial Institution using the same analysis that is pertinent to a 'public' trust company. For example, in the Guidance Notes on the International tax compliance requirements of the IGAs between the Cayman Islands and the United States of America and the United Kingdom, a PTC that is incorporated, registered or licensed and conducting business in or from within the Islands is considered a Financial Institution. However, even where it has been determined that a PTC is not conducting business, it may still opt to register as a Financial Institution.

    The OECD Secretariat advised it would be necessary to look at what the PTC did to determine whether it can qualify as a Financial Institution rather than a Non Financial Entity. Activities of the PTC may enable it to be treated as a Financial Institution.

7. **Paragraphs 207, 209 and 226 – trusts that are not resident or located in a Participating Jurisdiction**

    a. We would like to raise the position of trusts that are resident in the United States in the context of this guidance. Specifically, where a US trustee or trustees act

with respect to a trust that confers certain powers on a non-US person or entity, the trust may then be regarded as not fiscally resident in the US. We would like to understand specifically whether the US will be regarded as a 'Participating Jurisdiction' such that the trust will not be regarded as a passive NFE – if so, is this the case for all purposes or does it depend on the existence of a Type 1 IGA with respect to the countries of residence of Reportable Persons? In the context of the last sentence in Paragraph 209, we see that a trust can be treated as a Non-Reporting Financial Institution where the *'trustee undertakes all information reporting in respect of all Reportable Account of the trust'.* If the US is regarded as a Participating Jurisdiction, will these criteria be deemed to have been satisfied if a Financial Institution that operates a Reportable Account for the trust makes enquiry and seeks assurances that the trust concerned is not a passive NFE? This is equally relevant in the context of the opening sentence of Paragraph 226. Is the US regarded as a Participating Jurisdiction because of its FATCA model 1 IGA obligations?

b. Anecdotally we are aware that people are looking again at the US with a view to moving their business to US banks and US trusts. The risk here is that families seeking the right to privacy, albeit tax compliant, may be looking to not only move trusts to the US, but to also move the underlying bank accounts and investments from CRS countries, which has the potential to cause more damage to banks and other service providers in jurisdictions that are cooperating with CRS. Treating the US as a Participating Jurisdiction will result in information being exchanged with the US pursuant to both FATCA and CRS, and may put greater pressure on the US to broaden its information exchange in the years to come.

The OECD Secretariat advised that it was up to each jurisdiction to list Participating Jurisdictions in their domestic law, while respecting the criteria set out in the Standard. The OECD Secretariat noted that the UK does not currently treat the US as a Participating Jurisdiction.

8. Paragraphs 210 & 211 – dual resident trusts

We note the guidance about trusts being resident where the trustee is resident. We note that, in the case of corporate trustees (including both PTCs and regulated trust companies), the corporate trustee might well be incorporated and licensed in Jurisdiction A, but effectively managed and tax resident in Jurisdiction B. If one refers to Paragraph 97 in the context of guidance on the tax residence of entities, we consider that it would be correct to treat the trusts in these cases as essentially resident in both jurisdictions A and B with the necessary dual reporting. Is it possible in these circumstances for the trustee to rely on Paragraph 211 and only report in one of Jurisdictions A and B assuming both are Reporting Jurisdictions?

We note that this is permitted, for example, under the IGA between the Cayman Islands and the United Kingdom.

The OECD Secretariat confirmed that reporting would be required in both jurisdictions. The accommodation provided in paragraph 211 would only apply where the trust itself is treated as a separate tax resident person in a jurisdiction, and undertakes the required reporting. This is likely to be of limited application. However the option to allow the use of service providers may provide similar relief.

9. Paragraphs 214 and 227 – natural persons exercising effective control (**NPEEC**)

a. Other than the reference in this paragraph 'at a minimum' to the trustee being regarded as a NPEEC, we have been unable to locate any concrete guidance as

to which other natural persons will be regarded as falling within this 'residual' category of Controlling Persons.

b. We note the statement in paragraph 227 (in the context of trusts as NFEs) that '*the definition of Controlling Persons excludes the need to inquire as to whether any of these persons can exercise practical control over the trust'.* We do not believe this statement is logically correct for NPEECs because the exercise of control is an inherent part of the concept – we believe it would be helpful to identify some practical examples as to when a person, other than a trustee, would be regarded as an NPEEC as we know there is already widespread confusion as to how to interpret this phrase in the trust industry.

c. We are also aware of situations where there is 'two tier' governance in trusts – for example, person A (an individual) with significant powers that result in him being regarded as an NPEEC is appointed (and may be removed) by person B (also an individual). In this case, in what circumstances is it also correct to classify person B as an NPEEC?

The OECD Secretariat advised that the reference to 'any other natural persons exercising effective control' is designed as a residual category to ensure the rules cannot be easily circumvented. The language is intended to mirror the 2012 FATF Standards on the beneficial owners of a trust.

10. Paragraph 217 – look through Entities to Controlling Persons – where the Entity is an RFI

a. In some cases, there will be corporate protectors appointed with respect to a trust where an RFI is the trustee. If these corporate protectors have sufficiently wide powers, such that they would be potentially be regarded as Reportable Persons with respect to the trust if they were individuals (see comments in section 8 above on NPEECs), will it then be necessary to identify the distinct Controlling Persons of the corporate protector?

b. It is not uncommon for corporate protectors to be appointed who are regulated trustee service providers in their 'home' jurisdiction. Is it going to be necessary to perform an analysis on the Controlling Persons of such Entities (which is meaningless in tax reporting terms[1]), or would they not be regarded as Reportable Persons either because they are in effect Reporting Financial Institutions by analogy to the classification set out at paragraph 99 of the Handbook or because they are active NFEs?

In the OECD Secretariat's view it would be necessary to identify Controlling Persons in these circumstances. There was a discussion about certain types of structure where this could give rise to a problem, e.g. a corporate protector administered by a law firm which is owned by discretionary trusts established by the partners of that law firm. Following OECD Secretariat guidance would mean that Controlling Persons in relation to those discretionary trusts would also need to be disclosed even though they have no beneficial interest or control in the underlying trust of which the corporate protector acts as trustee. However, as noted in question 4, where the Reporting Financial Institution has information on the type of Controlling Person (such as being a protector), this must be included in the report. Doing so will enable the tax administration receiving the information to

[1] To give an example, we are aware of a corporate protector controlled by the partners of a Bermuda law firm which is owned by trusts set up for the benefit of their families. If it is necessary to provide information about the Controlling Persons relating to the Protector it may be necessary to provide information about Controlling Persons in relation to these trusts. This information is totally meaningless in tax terms for determining who has a financial interest in the Trust of which the corporate protector acts as protector.

make appropriate use of the information in tax compliance actions. It was agreed with the OECD Secretariat that some examples would be helpful.

11. Paragraph 220 – determination of account value of trust where trustee is an RFI

a. We note the reference to the '*value calculated by the RFI for the purpose that requires the most frequent determination of value'* is to be used for reporting the account value. There is no unified standard for the preparation of trust accounts and it is rare that trust accounts are subject to an audit. In many cases, the directly held trust assets may be shares in a holding company that is an Investment Entity and therefore a Financial Institution. It is also not unusual for the trust assets to be shown in trust accounts at historic cost, and there is no general requirement to 'mark to market' the trust assets annually. In such cases, can the trustee, as RFI, use the value of assets on acquisition either

   i. where the trust accounts show trust assets at historic cost; or

   ii. where the directly held trust asset are shares in one or more holding companies that are carried at historic cost.

b. It is also not clear, where the trustee is an RFI, whether the obligation to report the value of the trust requires them to report the full value of all trust assets or just the value of financial assets. This would not be the case for a trust that is an NFE, where the RFI in relation to the relevant accounts would only report the value of the financial assets held by that trust. We assume that the intention is that a trustee that is an RFI is only required to provide financial information about the financial assets and not the non-financial assets. If this is correct, it would be helpful if this could be made clear.

The OECD Secretariat advised that it would be necessary to disclose the full value of all assets in the trust, both financial and non-financial assets.

12. Paragraph 221 – changes with respect to Controlling Persons

a. We note the guidance that draws an analogy between closing a financial account and a change in status of a Controlling Person. We suggest this could helpfully be expanded.

b. Settlor – if a settlor/ beneficiary dies during a reporting period, we assume that the trustee, as RFI, would **not** report the total account balance per table 7, but simply report the notional 'closure' of the settlor's deemed 'financial account' in the trust assets?

c. Settlor – if a settlor/beneficiary is irrevocably excluded from the trust as a beneficiary during a reporting period, what report should be given in this instance? Is it correct to report the fact of exclusion and then only report the bare fact that the settlor remains the settlor during his or her lifetime but with a 'nil' report on his/her financial account?

d. Change in beneficiary status (1) – if a beneficiary (not a settlor) who was previously entitled to all trust income has his income rights removed and becomes a discretionary beneficiary only or dies, we assume by analogy to the point made above that the trustee, as RFI, would **not** report the total account balance per table 7, but simply report the notional 'closure' of the beneficiary's deemed 'financial account' in the trust assets and the date of 'closure'?

e. Change in beneficiary status (2) – if a beneficiary (not a settlor) who was previously a discretionary object becomes entitled to all trust income during a

reporting period, we assume that the trustee, as RFI, would report the total account balance and the date when the interest arose?

f. NPEEC – if there is an NPEEC whose powers are revoked or modified (or simply retires from office), we assume that the trustee, as RFI, would report the notional account 'closure' and the date it occurred?

The OECD took the view that these events would be treated as the closure of the account. It was necessary only to report the fact of closure of the account and not the value of the account at that time. [Consultation ongoing on this point]

13. Paragraph 222 Table 7 in comparison to Paragraph 237 Table 8 – position of protectors and debt holders

a. Trusts where trustee is an RFI (Table 7)

i. Settlors

If a settlor is wholly excluded and may not benefit from a trust, should a trustee take the position in the context of paragraph 222 that the settlor, whilst reportable, should have an interest with a 'nil' value?

The OECD Secretariat advised that it would be necessary to disclosure the full value of the trust assets.

The OECD Secretariat agreed to follow up on whether it was necessary to disclose information about a dead settlor. It was noted that information as to a dead settlor was not normally required as part of standard KYC requests. OECD Secretariat would consider this. [Consultation ongoing on this point]

ii. Protectors

We note in paragraph 109 that while protectors are included in the Controlling Persons definition and appear in Table 8 where trusts are NFES as requiring 'full balance sheet' reporting, they are not expressly mentioned in Table 7 or in paragraph 214 where the trustee is an RFI. We think it would be helpful to be clear in the context of our comments with reference to Paragraph 214 in the context of NPEECs in what circumstances the powers of an individual protector will be regarded as sufficiently wide as to require reporting where the trust is an RFI. Can we assume that, in the absence of being treated as an NPEEC, a protector who simply serves as a protector who is not otherwise a Controlling Person as a settlor or beneficiary is not required to be reported upon by the RFI?

The OECD Secretariat confirmed that protectors should be included in Table 7.

iii. Debt holders

We note that Table 7 includes a reference to debt interest holders, but that this is not repeated in Table 8. What is the rationale for this difference of approach?

OECD Secretariat confirmed that the account holders for a trust that is an RFI are both the debt interest holders in the trust and Equity Interest holders in the trust. The account holders for a trust that is a Passive NFE and that has a Financial Account with an RFI are the Controlling Persons of the trust, but not debt interest holders.

b. Trusts where trust is an NFE (Table 8)

We note under Table 8, and based on the concept of protectors always being included in the Controlling Persons definition for trusts that are NFEs (as noted in Paragraph 227), the reporting required in respect of protectors by the RFI is of the full value of the account. In many cases, trusts may well have one or more individual protectors who are serving as protectors in the course of a business and who have no possibility to benefit as a beneficiary. If the reporting proposed in Table 8 is not modified for individual professional protectors, then each individual protector will have a report made to his or her home tax authority with the balance on a bank account for the NFE trust, even though he or she has no personal connection except in serving as a protector. Is this what is intended? As the relevant jurisdiction in which the protector is based will have no taxing interest in the trust, we are concerned it could create a lot of confusion and lead to unnecessary costs being incurred by both tax authorities and individual taxpayers. If it is not desirable to make the change suggested in paragraph 4 above to only provide information about protectors who are also beneficiaries of the trust, can we suggest that the guidance be refined so that where the protector is not a beneficiary and has no prospect of becoming one, the report to his or her home tax authority makes it clear that the role is purely a professional one?

The OECD Secretariat noted that the Standard requires RFIs to report the type of Controlling Person, where such information is available. In respect of New Accounts, this is generally likely to be the case. As such, the receiving tax authority would have notice of the account holder type, and would make tax compliance interventions as appropriate.

14. Paragraph 236 – reporting settlor's interest where a trust is an NFE

a. We note that paragraph 236 states that each Controlling Person '*is attributed the entire value of the account'.* Is this the case for settlors even if they are totally excluded and have no possibility to benefit from the trust? We are not clear as to the policy reason why a settlor of a trust, who is not a beneficiary and retains no rights over the trust assets, should be in a different position than, for example, an individual who has transferred assets to a partnership set up for the benefit of his family (see paragraph 3 above).

b. By analogy, with regard to what is reported for mandatory beneficiaries with *partial interests* – we assume just the part of the trust capital to which their interest relates if they receive the income from a fixed proportion of the capital or, if they receive a fixed distribution from the trust, the value of the annual distribution?

The OECD Secretariat noted that work is ongoing to guide tax administrations in the effective use of information, including the analysis of information received in respect of trusts.

15. Page 94 – Passive NFE definition

a. We note the distinction made with FATCA in the context of Investment Entities that are not resident in a Participating Jurisdiction that will require the Controlling Persons to be identified on the basis that they will be treated as NFEs for CRS regardless of their actual status.

b. Where such an Investment Entity is 100% held directly or indirectly by a trust (whether or not the trustee is an FI or NFE) it would seem that, as the relevant

Controlling Persons will be those that are in any event reportable in the context of the trust, no additional reporting arises in practice. Do you agree?

The OECD noted that where there is an NFE in a chain of entities, it is necessary to identify the Controlling Persons in relation to that NFE, even if any of the entities above the NFE are Reporting Financial Institutions. [Consultation ongoing on the practical implementation of this point]

The Economist

Financial transparency

The biggest loophole of all

Having launched and led the battle against offshore tax evasion, America is now part of the problem

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DEVIN NUNES raised eyebrows in 2013 when, as chairman of a congressional working group on tax, he urged reforms that would make America "the largest tax haven in human history". Though he was thinking of America's competitiveness rather than turning his country into a haven for dirty money, the words were surprising: America is better known for walloping tax-dodgers than welcoming them. Its assault on Swiss banks that aided tax evasion, launched in 2007, sparked a global revolution in financial transparency. Next year dozens of governments will start to exchange information on their banks' clients automatically, rather than only when asked to. The tax-shy are being chased to the world's farthest corners.

And yet something odd is happening: Mr Nunes's wish may be coming true. America seems not to feel bound by the global rules being crafted as a result of its own war on tax-dodging. It is also failing to tackle the anonymous shell companies often used to hide money. The Tax Justice Network, a lobby group, calls the United States one of the world's top three "secrecy jurisdictions", behind Switzerland and Hong Kong. All this adds up to "another example of how the US has elevated exceptionalism to a constitutional principle," says Richard Hay of Stikeman Elliott, a law firm. "Europe has been outfoxed."

The Foreign Account Tax Compliance Act (FATCA), passed in 2010, is the main shackle that America puts on other countries. It requires financial institutions abroad to report details of their American clients' accounts or face punishing withholding taxes on American-sourced payments. America's central role in global finance means most comply.

FATCA has spawned the Common Reporting Standard (CRS), a transparency initiative overseen by the OECD club of 34 countries that is emerging as a standard for the exchange of data for tax purposes. So far 96 countries, including Switzerland, once favoured by rich taxophobes, have signed up and will soon start swapping information. The OECD is also leading efforts to force multinationals to reveal more about where and how profits are made, and the deals they cut with individual governments, in order to curb aggressive tax-planning.

Because it has signed a host of bilateral data-sharing deals, America sees no need to join the CRS. But its reciprocation is patchy. It passes on names and interest earned, but not account balances; it does not look through the corporate structures that own many bank accounts to reveal the true "beneficial" owner; and data are only shared with countries that meet a host of privacy and technical standards. That excludes many non-European countries.

All this leads some to brand America a hypocrite. But a fairer diagnosis would be that it has a split personality. The Treasury wants more data-swapping and corporate transparency, and has made several proposals to bring America up to the level of the CRS. But most need congressional approval, and politicians are in no rush to enact them. Some suspect that their reluctance, ostensibly due to concerns about red tape, has more to do with giving America's financial centres an edge.

Meanwhile business lobbyists and states with lots of registered firms, led by Delaware, have long stymied proposed federal legislation that would require more openness in corporate ownership. (Incorporation is a state matter, not a federal one.) America will often investigate a shell company if asked to by a foreign government that suspects wrongdoing. But incorporation agents do not have to collect ownership information. This is in contrast to Britain, which will soon have a public register of companies' beneficial owners.

America the booty-full

No one knows how much undeclared money is stashed offshore. Estimates range from a couple of trillion dollars to $30 trillion. What is clear is that America's share is growing. Already the largest location for managing foreign wealth, it has picked up business as regulators have increased information-exchange and scrutiny of banks and trust companies in Europe and the Caribbean. Money is said to be flowing in from the Bahamas and Bermuda, as well as from Switzerland.

A recent investigation by Bloomberg, a news provider, found several wealth managers whose American arms have benefited, including Rothschild, a British firm, and Trident Trust, a provider of offshore services. New business has been booked through subsidiaries in states with strong secrecy laws and weak oversight, such as South Dakota and Nevada. Another investigation, by *Die Zeit*, a German newspaper, concluded that for the tax cheat looking to pull money out of Switzerland, America was now the safest bet. "It's going nuts. Everyone is doing it or looking into it," says a tax consultant, speaking of the American loophole. Some transfers are being requested for legitimate reasons of confidentiality—for instance, by Venezuelans who fear extortion or kidnap if their wealth is known. But much is of dubious legality.

America is much safer for legally earned wealth that is evading taxes than for lucre that was filthy from the start. It has shown little appetite for helping enforce foreign tax laws and, unlike some other countries, does not count the banking of undeclared money as money-laundering. "Foreigners looking to evade tax in America are usually safe because of its secrecy," says Jason Sharman of Griffith University in Australia. "But for those with dirtier money there is a small though real risk the US will investigate and apply the full force of the law, which is a scary prospect."

Dividing the spoils

Foreign banks losing business to America can sometimes share in the profits, explains one tax consultant. A Swiss bank, say—generally a smaller one, as big ones are too scared—tells its client to close an account and open one with an American custodian bank. The client then appoints the Swiss bank as investment manager on the custodian account, and that bank instructs the custodian which funds to buy, often the Swiss bank's own products. The Swiss bank earns fees for advice and fund-management; the custodian picks up business; and the account is deemed for regulatory purposes to be American, meaning it avoids the disclosure rules that apply only to countries signed up to the CRS.

Only a few other financial centres have declined to commit themselves to the CRS, among them Bahrain and Nauru. Hong Kong has signed but will implement it one tax-treaty partner at a time rather than using a multilateral shortcut; some regard this as a delaying tactic. Undeclared Asian and Middle Eastern money is moving to Taiwan and Lebanon, respectively, both of which are outside the club. Panama, which vies with Miami for Latin American money, looks set to back out of its tentative commitment to the CRS, using America's double standards as an excuse (see article (http://www.economist.com/news/international/21693221-tax-haven-professes-stand-principle-risking-pariah-status-problem-child)).

Frustration with America has grown in Europe, which forms the core of the CRS. A group in the European Parliament argues that, if America refuses to reciprocate fully, it should be hit with a reverse FATCA: a levy on payments originating in the EU that flow through American banks. "We don't want a tax war, but nor can the US have it all its own way," says Molly Scott Cato, one of the MEPs. One obstacle is that tax measures must be approved unanimously by the EU's 28 member states.

Others point out that the CRS itself has flaws. It was drafted in a rush, and one expert thinks it would fail to catch 80% of tax-dodging. Financial firms have been calling to report loopholes that could benefit less scrupulous rivals, most of which will be closed before it comes into force or soon after, promises the OECD. (Keeping banks' compliance costs within reasonable limits means that some will inevitably remain.)

America deserves great credit for taking on Switzerland and other long-standing tax havens. And a Treasury official insists that stashing undeclared loot there will not remain possible for long: "This is something that will be fixed." Until it is, America will be the biggest tax loophole of all.

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