FATCA and CRS

Your obligations now…
and in the future

The Bright Alternative

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Introduction

At Aztec, we regularly field questions and queries on FATCA and CRS from clients keen to understand the mechanics of this legislation and how their business is impacted. So, with that in mind, we wanted to provide a whistle-stop tour of the world of FATCA and CRS.

Most people working in financial services will be well acquainted with the acronyms FATCA and CRS. FATCA (the Foreign Account Tax Compliance Act) and CRS (the Common Report Standard) legislation were introduced in 2010 and 2014 respectively, and aim to help combat tax evasion by requiring financial institutions to report specific details on certain account holders to their country (or countries) of tax residence.

If you're an investment manager, you're probably in scope, with FATCA and CRS reporting being very much part of your world. But managers who outsource their regulatory reporting will recognise the fact that while you can outsource responsibility, the same doesn't apply to accountability. Both FATCA and CRS can sometimes feel like a bit of a minefield, which is why our discussions with clients invariably focus on the 'need to know' aspects of the legislation, rather than 'nice to know'. We've laid out the essential information in this short guide.

What we'll cover in this guide:

The scope of FATCA and CRS

In simple terms, FATCA concerns the reporting on US tax residents to the Internal Revenue Service (IRS) by financial institutions, whereas CRS is focused on the exchange of financial information on a global level between tax authorities.

113 countries

have entered into intergovernmental agreements with the US and introduced FATCA legislation

109 entities

have signed up to CRS, meaning that most of the jurisdictions in which our clients operate are in scope

The scope

The legislation affects all entities, as each entity has a responsibility to classify themselves for both FATCA and CRS purposes. Depending on the classification of the entity, further requirements are then applicable, such as performing FATCA and CRS investor due diligence and reporting on an annual basis.

Key definitions

Entities can either be classified as a 'Financial Institution' (FI) or as a 'Non-Financial Entity' (NFE). A **Financial Institution** is any entity that meets the definition of a Custodial Institution, a Depository Institution, an Investment Entity, or a Specified Insurance Company. Financial Institutions will be Reporting Financial Institutions for FATCA and CRS (although exemptions are available for certain types of Financial Institutions). An **NFE** is any entity that does not meet the definition of a Financial Institution.

NFEs are then classed as either Active or Passive depending on the activities undertaken and income earned

Active NFE

An Active NFE is any one of the following: By reason of income or assets (less than 50% of income and assets held are passive in nature); publicly-traded NFEs; governmental entities; international organisations; central banks, or their wholly-owned entities; holding NFEs that are members of a non-financial group; start-up NFEs, NFEs that are liquidating or emerging from bankruptcy; treasury centres that are members of a non-financial group, or non-profit NFEs.

Passive NFE

A Passive NFE is any non-financial entity that does not meet the definition of an Active NFE. Some examples of passive income include dividends, distributions, and interest income.

Understanding your requirements

As an investment manager with investment funds and investors spanning multiple locations, the likelihood is your funds will be classified as a Reporting Financial Institution. As a result, you'll have the following additional responsibilities for those entities:

- Registration with the IRS and appointment of a Responsible Officer (FATCA only)
- Development and documentation of FATCA and CRS policies and procedures
- Performance of investor due diligence on all financial account holders
- Annual reporting

Registration with the IRS and appointment of a Responsible Officer (FATCA only)

A Reporting Financial Institution has an obligation to register with the IRS for a Global Intermediary Identification Number (GIIN). During the registration process, you are required to provide the details of the person who will act as the Responsible Officer for the Reporting Financial Institution.

That person's main duties will include:

- Certifying compliance of the Financial Institution with FATCA to the IRS
- Establishing a FATCA compliance programme
- Notifying the IRS of material failures or non-compliance with FATCA requirements

Developing and documenting FATCA and CRS policies and procedures

All Financial Institutions are required to put in place appropriate policies and procedures to ensure that the requirements included in the FATCA and CRS legislation are implemented. These should be documented and available for the tax authorities to review in the event of an audit.

Performing investor due diligence on all financial account holders

For each financial account holder onboarded, the Financial Institution must obtain a self-certification. This must be reviewed and a sense check performed against the other information held on the account holder within 90 days.

Annual Reporting

In drafting the annual reporting, the Financial Institution is required to identify any reportable financial accounts. A report is then prepared for the reportable financial accounts.

Annual reporting: your key questions answered

Q. Which financial accounts are reportable for FATCA?

A. Specified US Persons and Passive Non-Financial Foreign (non-US) Entities (NFFEs) where any controlling persons are Specified US Persons.

Q. Which financial accounts are reportable for CRS?

A. Individuals from a CRS-reportable jurisdiction, Passive NFEs, in respect of the entity themselves and any controlling persons from a CRS-reportable jurisdiction, and certain types of Active NFEs.

Q. What information is reported?

A. Depending on the reporting jurisdiction, additional information may be mandatory, but, in general, the following fields are included in the annual reporting for each reportable financial account:

- Name
- Address
- Tax residency and taxpayer identification number (TIN)
- Account number
- Type of financial account
- Financial information (account balance at the year-end and payments made during the reporting period)
- For Controlling Persons: name, address, tax residency and TIN and type of controlling person

Q. What happens to the information after it is reported?

A. Reporting is submitted to the tax authorities in the location where the Financial Institution is tax resident. The tax authorities will then perform sense checks and validations of the information and split the reportable financial accounts according to jurisdiction of their tax residency. If the sense checks reveal any discrepancies, the tax authority may follow up with the Financial Institution for further information.

Once processed, the reporting will be forwarded to the relevant tax authority. For example, where a Luxembourg Financial Institution has reportable financial accounts from France and Germany, the reporting should be submitted to the Luxembourg tax authorities for processing. The Luxembourg authority will process and forward the information on all the French tax resident financial accounts to the French tax authorities, and information on the German financial accounts to the German tax authorities.

The exchange of information between tax authorities takes place at the end of September in the year following the reporting period.

The receiving tax authority will use this information to cross-check against other information held. One use of the information would be to validate tax returns submitted, to ensure all relevant foreign income has been declared.

The future of FATCA and CRS

Some countries have updated their FATCA and CRS legislation to include additional requirements, and we have identified several broad themes that Financial Institutions should be aware of:

1. Nil returns: If the Financial Institution does not identify any reportable financial accounts, a 'nil return' can be submitted to confirm this. When FATCA and CRS were first implemented, nil returns were generally not required and were optional. However, several countries have updated their legislation to make nil returns mandatory. In the future, we expect most jurisdictions will require nil returns for both FATCA and CRS.

2. Additional reporting requirements: We have recently seen two jurisdictions (Cayman Islands and Guernsey) implement additional reporting requirements that go beyond the standard reporting we've described.

3. Cayman Islands: Starting with the 2019 reporting period, the Cayman Islands introduced an additional CRS Compliance Form to be submitted on an annual basis. This includes a confirmation that appropriate written policies and procedures are in place, and have been complied with during the reporting period.

The form also asks for further details on the non-reportable financial accounts, including type and total account balances held by non-reportable accounts.

4. Guernsey: From the 2020 reporting period onwards, Guernsey now requires a CRS Compliance Assurance Statement to be submitted alongside the annual CRS report. This includes confirmation that appropriate written policies and procedures are in place, and have been complied with during the period. The Statement also requires explicit confirmation that all accounts closed during the period have been appropriately included, and that the report submitted includes all required details and reportable financial accounts.

As more countries introduce additional reporting requirements, this will likely become the norm, rather than the exception. However, Revenue Jersey recently indicated it has no plans to implement additional compliance reporting at present.

5. Additional investor due diligence requirements: Germany recently updated its CRS legislation to include additional requirements relating to investor due diligence procedures. With effect from 1 July 2021, should a Financial Institution be unable to obtain self-certification within 90 calendar days of account opening, or its plausibility cannot be confirmed, the Financial Institution is required to immediately inform the Federal Central Tax Office.

6. Increased IRS focus on missing US TINs for Specified US Persons: For the 2020 reporting period, the IRS provided a list of default TINs that should be used where a Financial Institution has been unable to obtain a valid US TIN for a Specified US Person in advance of the reporting deadline. However, where these default TINs have been used, the IRS will return an error and request a correction file with a valid US TIN.

In practice, Financial Institutions should be regularly following up with financial account holders for any outstanding information. Detailed records of the attempts made should be kept, as the IRS will require evidence that the Financial Institution has complied with its obligations to obtain sufficient investor due diligence.

7. FATCA and CRS Audits: Following the release of the "Guide on Promoting and Assessing Compliance by Financial Institutions" published by the Organisation for Economic Co-Operation and Development (OECD), there has been an increased focus on firms proving regulatory compliance.

We have noted increased communications from tax authorities indicating their intentions to audit the implementation of FATCA and CRS legislation by Financial Institutions. While the nature of these audits will vary between jurisdictions, it is likely that the tax authorities will ask to see the Financial Institution's written policies and procedures, as well as evidence of controls in place and the implementation of policies and procedures by the service provider (should FATCA and CRS be outsourced).

Final thoughts…

Given the increased scrutiny from tax authorities, Financial Institutions should be reviewing their current policies and procedures and assessing whether these are fit for purpose, or whether they can be improved following the OECD's recommendations.

If you outsource FATCA/CRS to a service provider, please be aware that you should also have appropriate policies and procedures in place at the Financial Institution level. While these may not be as complex or comprehensive as if you were performing the work in-house, they should be sufficiently detailed to demonstrate you are meeting your obligations under the FATCA and CRS legislation.

Get in touch

If you would like to discuss your FATCA and CRS obligations, as well as how Aztec can support you, please talk to either your usual Aztec Group contact or get in touch with our Technical Team:

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