

Extension of the automatic exchange of information on EU level and global OECD information exchange

Current status

After the implementation of FATCA (Foreign Account Tax Compliance Act) on July 1st 2014, banks and other financial institutions in Europe and all over the world are facing further challenges regarding the disclosure of capital assets of their clients.

The automatic exchange of information (AEOI) is still on the rise and should reduce tax evasion by usage of foreign accounts. Further, the taxation of capital income should become more transparent.

In order to reach this target the following changes are planned:

1. Reform of EU directives

1. Extended Directive Administrative Cooperation exchange
2. Revised European Savings Directive

2. Implementation of an OECD Common Reporting Standard

This will cause major adjustments in the IT landscapes and the compliance areas of financial institutions.

In this newsletter we will take a closer look at the planned respectively already agreed upon reforms with respect to the financial industry.

1.1 Extended Directive Administrative Cooperation exchange

The extension of the Directive Administrative Cooperation, which is based on a recommendation of the EU commission from June 12th 2013 stipulates that each EU member country has to inform any other EU member country as of January 1st 2016 if certain capital income is paid by a financial institution to an individual with residence in that other EU member country. Relevant is also the collection of receivables or holding of assets for a beneficial owner.

Capital income which is in scope of that directive, is:

- Dividends
- Capital gains
- Any other income generated with respect to the assets held in a financial account
- Account balances

In this respect an automatic exchange of information should take place at least once per year. The report should be exchanged within six months after the end of the tax year of the respective member country.

Basis of that automatic exchange of information should be the IGA model 1 of FATCA, in order to reduce implementation effort and costs for financial institutions.

The extension should be passed until the end of 2014. Then, hopefully further information in respect to the actual implementation in single countries should be available.

1.2 Revised European Savings Directive

The European Savings Directive is applied within the EU and between the EU and different third countries with which bilateral agreements have been signed (e.g. Switzerland and Liechtenstein) since July 1st 2005.

With the reform of the EUSD its application should be revised. The changes were adopted in March 2014 and have to be implemented in the single EU member countries until the beginning of 2017.

The following changes are planned:

- Abolishment of tax withholding as alternative to reporting
- Improvement of the quality of information used to establish the identity and residence of the beneficial owner by collection of place of birth, birthday and tax identification number (TIN)
- Application of a "Look-through-approach" in case of payments made to certain entities or legal arrangements established or having their place of effective management in certain countries or territories. The paying agent has to report if he is informed about individuals which are beneficial owners of the entity and resident in an EU member country different from the country of residence of the paying agent. In order to reduce administration costs a list with relevant legal forms of companies will be published.
- Extension of the term "paying agent": in scope are also economic entities residing outside of the EU receiving interest payments for customers with residence in the EU. This should prevent the evasion of reporting.
- In this respect there is also a redefinition of the term "paying agent": entities or legal arrangements are regarded as paying agents if they are not effectively taxed and receive interest payments. The relevant company structures will also be published in an annex.
- Extension of the range of financial products that are in scope to "interest like" products which are similar to 'normal' interest income as far as the involved risk, flexibility and return are concerned; this also includes certain types of income from life insurances.
- Extension of the term "investment funds": no more reference to OGAW; independently of their legal form interest income has to be considered (in the future this also applies for funds domiciled in the EEC and certain third countries).
- Further, clearer definitions of investment funds income: income of all investment funds which invest in receivables have to be considered

2. Common Reporting Standard (CRS)

With the OECD reporting standard the automatic exchange of tax information on a global (and not only on EU) level should be possible. Thereby standardized rules should be developed which can then be agreed in bilateral treaties. The standard contains recommendations to which information has to be reported by which financial institution to the local tax authorities and for which tax payers the regulations are applicable.

The CRS is largely based on the FATCA Intergovernmental Agreement (IGA) Model 1 and should lead to a first exchange of information between the respective authorities of the participant states in 2017. In order to enable this the CRS has to be adopted into national law. Currently more than 44 countries ("early adopters") have announced that they will implement the CRS as soon as possible.

It is expected that the OECD will publish a commentary to the CRS as well as information to a technical solution in summer 2014, in order to ensure a standardized application of the standard. The standard should be passed at the G20 summit in September 2014.

Individual scopes

1. Financial institutions with reporting obligations

Subject to report are - beside banks - also other financial institutions like brokers, certain insurance companies and certain collective investment vehicles.

2. Relevant clients/accounts

The reporting is foreseen for individuals as well as for legal entities (e.g. trusts and foundations). If the accounts are held by passive legal entities also the individuals behind the entity have to be reported (so-called "look-through-approach").

This will cause comprehensive examinations when opening new accounts but also the duty to classify existing accounts (see also under 4.).

3. Reportable data

- Interest payments
- Dividends
- Other income deriving from financial investments
- Income from insurance products
- Gross proceeds from sale or redemption of property
- Account balances

4. Account Due Diligence

Depending on the account balance as of 31.12.2005 the existing accounts have to be checked for relevance. In case of so-called high-value-accounts (with an account balance of at least 1 Mio. USD) the customer identification has to be completed until 31.12.2016 so that for these accounts as well as for accounts opened since 01.01.2016 the automatic exchange of information can be implemented until 30.09.2017.

In case of so-called lower-value accounts, i.e. accounts with a balance under 1 Mio. USD, the customer identification has to be completed until 31.12.2017, so that information can be automatically forwarded for the first time as of 30.09.2018.

Comparison with other regulations concerning the automatic exchange of information

The planned regulations of CRS are generally based on FATCA (IGA Model 1), however there are some noteworthy differences. For example, for the identification of the tax residence only the domicile respectively the permanent residence is relevant and not the citizenship.

Further, the complexity compared to FATCA is higher since the number of relevant clients is much higher and the regulations are reaching much further based on the number of countries that have to be considered.

However, the single regulations must not be seen separately since generally a harmonization with the other regulations should take place. Therefore, the EU regulations as well as the OECD regulation should eventually be unified. The aim is to have only one standard. It is expected that there will be progress in this area until the end of this year.

Since the EU as well as the countries that would like to implement the automatic exchange of information on OECD basis push for a fast introduction, the implementation of the regulations should be initialized and planned by the financial institutions as soon as possible in order to comply with the planned implementation deadlines.

Outlook

The upcoming extensions of the automatic exchange of information lead to an enormous implementation efforts for the impacted financial institutions even though a harmonization of the individual projects is targeted on the basis of FATCA model IGA 1. Since the community of states pushes for tight implementation timelines, banks should start to work on the necessary adjustments of their reporting systems.

In this regard it should also be considered that the individual regulations and the extensions on level of the EU respectively on a global level contain some differences. The regulations basically have to be looked at as a whole, but on the differences have also to be kept in mind, for example in respect to relevant clients or effective date of reporting. Since the rules for automatic exchange of information are still subject to changes, the extensions of the systems should be planned as flexible as possible so that adjustments based on newly available information can be implemented easily.

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