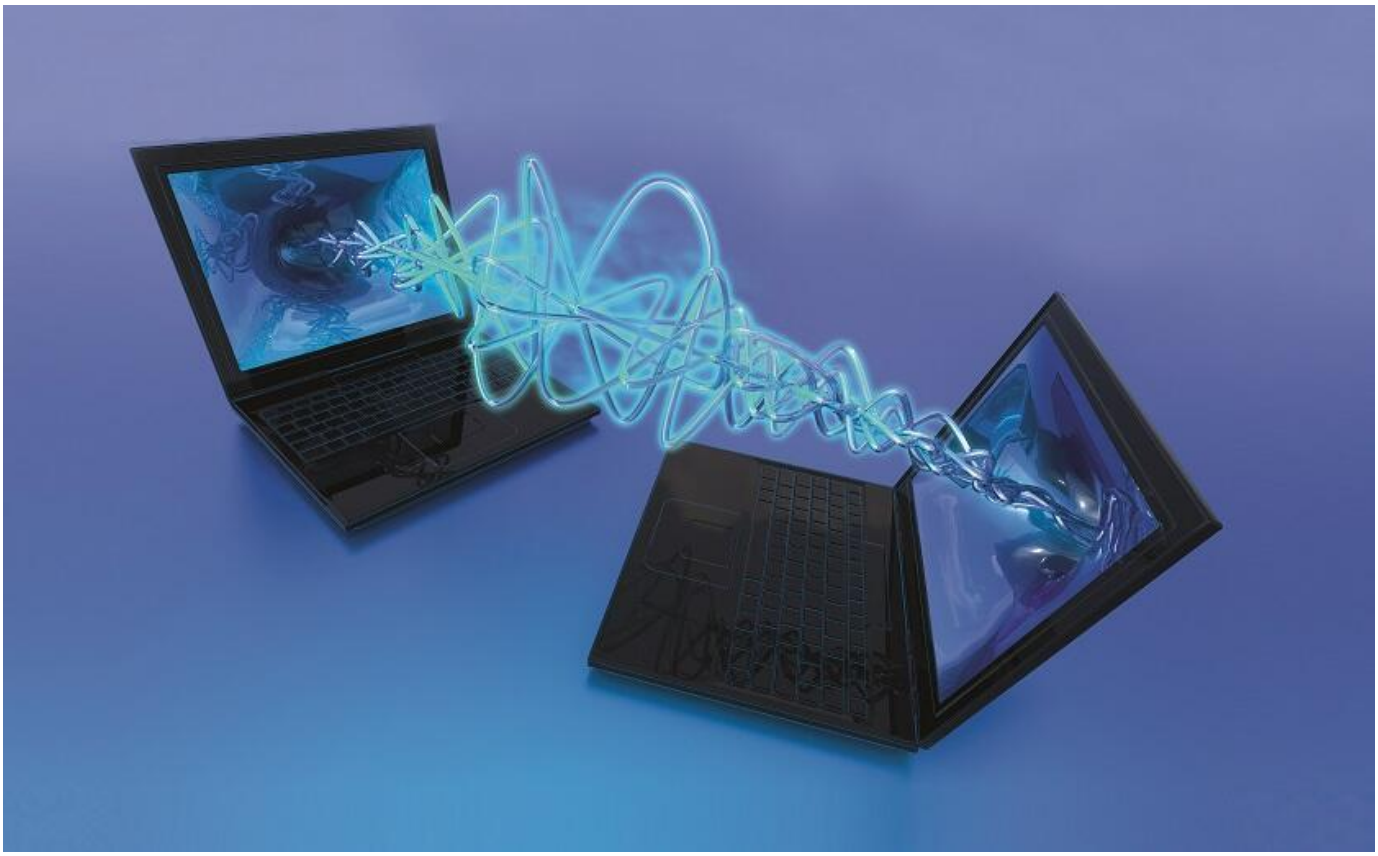
International exchange

Large Corporate



01 August 2015

Christopher Lallemand considers recent developments in international reporting of financial information for tax purposes

Key Points

What is the issue?

Regulations issued in April 2015 amended the FATCA reporting obligations to HMRC and covered reporting under the common reporting standard and EU agreement

What does it mean for me?

There is no longer an obligation to file nil returns, though there may be circumstances when this is necessary. Some of the definitions relevant for UK FATCA compliance have changed, although these should, in principle, follow those agreed between the US and OECD in relation to the common reporting standards

What can I take away?

The regulations now clarify that financial institutions retain responsibility for compliance and due diligence obligations when using agents. Although the three types of agreement are not identical, they should generally be consistent in interpreting the terms used

HMRC have changed the way companies must comply with FATCA, clarifying the obligations including those under the common reporting standards and relieving some businesses of the need to file. In March 2015 HMRC announced that the submission to HMRC of nil returns of FATCA information were no longer required and that the UK regulations on FATCA compliance would be amended. They concluded that ‘relevant holding companies’ and ‘treasury companies’ should not be reporting financial institutions purely as a result of SI 2014/1506 regs 7 and 8.

The updated regulations became effective on 15 April 2015 (SI 2015/878) and revoked the previous ones (SI 2014/1506). The reporting information and obligations, due diligence requirements and penalty provisions were clarified for:

- the UK/US inter-governmental agreement (IGA, dated 12 September 2012);
- the Multilateral Competent Authority Agreement on the Automatic Exchange of Financial Information signed by the UK and others on 29 October 2014 (CRS); and
- the EU Directive on Administrative Cooperation in the field of taxation (‘DAC’ – 2011/16/EU, as updated by Directive 2014/107/EU, which in effect implements the CRS in the EU).

Where businesses had based their compliance for treasury and holding companies on the old regulations, this may have implications for their structure. So HMRC issued a further update on 21 May on how groups with these entities could continue with their UK/US IGA obligations with respect to which entity is identified as the lead financial institution (FI). The update is found on GOV.UK.

The abandoning of the obligation to file nil reports for FATCA purposes and the removal of two categories of FI will be a huge relief to many UK entities with no US connections.

The IGA permits some ‘pre-existing accounts’ to be ignored in the due diligence procedures (those to identify ultimate account owners or beneficiaries from the US) required under that agreement, unless an election is made to apply due diligence procedures to all accounts. If an account is identified as reportable, specified information will need to be collected and reported.

The old and the new UK regulations referred to above overrode the IGA by requiring an election to be made to ignore due diligence on those pre-existing accounts. The method of making this election is to include it in the annual return for each year that it is applied, so a nil return may still be required.

The first deadline for reporting under the IGA has passed. Reports were due by 31 May 2015 covering the calendar year 2014. Any reporting FIs that have not already filed will need to be ready with their reasonable excuse for not doing so in order to avoid ‘failure to comply’ and ‘daily default’ penalties. Uncertainty on the practical application of the rules created by the changes above may provide the background to a reasonable excuse argument. HMRC’s August 2014 guidance did also indicate that, in general, those who made good faith efforts despite minor administrative errors would be viewed as compliant.

DAC and CRS

SI 2015/878 takes account of reporting obligations under the DAC and CRS. As for the IGA there is no requirement to submit nil returns. Similarly, an annual election must be made for any exclusion for some pre-existing accounts from due diligence procedures – the statutory instrument overrides the agreements – so a nil return may be required in any event. However, the first reports under the DAC or CRS will only be required by 31 May 2017 for information for the 2016 calendar year. In this context, a reportable account will be a financial account maintained by a UK FI and held by a person, a reportable person or entity, from the relevant foreign jurisdiction or a passive non-financial entity controlled by persons from the relevant foreign jurisdiction. Although the content of the IGA, CRS and DAC is similar, there are some differences.

Where a reporting FI under FATCA may have no reportable accounts under that agreement, due to not maintaining accounts for US persons or entities controlled by US persons, it may well have reportable accounts under the DAC and CRS if persons from the relevant foreign countries hold or have interests in those accounts.

Although the UK is a signatory to the multilateral competent authority agreement, it has still to agree the data confidentiality aspects of exchange of information with the counterparty countries under CRS. These are already agreed for the EU, so there is no barrier to exchange of information under the DAC between the UK and any EU member state.

Definition of investment entity

A ‘reporting’ FI under all the agreements means one of these categories that is not specifically identified in the agreement and its annexes as a non-reporting FI:

- a custodial institution;
- a depository institution;
- an investment entity; and
- a specified insurance company.

Under the IGA it is no longer necessary to consider whether an entity is a reporting entity by classification as a ‘relevant holding’ or ‘treasury’ company, but there is still a need to consider whether it falls under another heading. One category that might be relevant to many UK businesses is ‘investment entity’. The IGA defines this as:

> Any entity that conducts as a business (or is managed by an entity that conducts as a business) one or more of the following activities or operations for or on behalf of a customer:
>
> 1. trading in money market instruments (cheques, bills, certificates of deposit, derivatives, etc), foreign exchange, exchange, interest rate and index instruments, transferable securities, or commodity futures trading;
> 2. individual and collective portfolio management; or
> 3. otherwise investing, administering, or managing funds or money on behalf of other persons.

The HMRC guidance of 28 August 2014 explaining how the IGA and the related regulations are to be implemented includes this note:

> ‘A Financial Institution must apply the UK Regulations in force at the time with reference to the published HMRC Guidance. However, where a Financial Institution identifies an alternative element of the US Regulations or alternative element of a different Intergovernmental Agreement that it feels it would like to apply, then it should contact HMRC to discuss the issue.’

The definitions in IGA are not as comprehensive as in the US regulations (US Treasury Regulations §1.1471 – §1.1474). However, that agreement indicates that any term not otherwise defined in the agreement is interpreted either:

- according to common agreement between the UK and US as permitted by UK law; or
- using UK laws, with tax laws prevailing over other laws.

With the revocation of the old regulations there is now nothing from a UK perspective, other than the current outdated HMRC guidance, to say that an investment entity conducting a particular financial activity as a business is by reference to a 50% or more turnover test for the purposes of the IGA. If one had to rely on the UK tax definition of what is meant by ‘conducting as a business’, the number of entities classified as an investment entity could be significantly higher.

The OECD CRS and DAC definition of an investment entity uses this 50% turnover test and closely follows the US meaning. Helpfully, the HMRC FATCA team has indicated informally that the CRS is designed to be consistent with FATCA and has been agreed by the US to be so. In its view there is therefore a clear rationale for adopting the CRS approach to the definition of an investment entity for UK purposes in respect of the IGA. It is understood that HMRC will update its 2014 guidance to cover this and other points.

The OECD text and commentary on the model competent authority agreement for the automatic financial account information exchange to improve international tax compliance and the CRS can be found here.

Holding and treasury companies

Although specific reference to holding and treasury companies as reporting FIs has now been removed, it will be necessary to consider whether these types of entity come within any of the revised definitions of a reporting FI. Where they do not, HMRC has indicated they will be non-financial foreign entities (NFFE) and a decision will need to be made on whether they are active of passive for declarations on W-8BEN-E for certification purposes when dealing with other FIs.
When considering whether a holding company or treasury company falls within the investment entity category, the OECD commentary on the CRS definition of that category indicates it could include, among other entities, those that function or hold themselves out as:

- collective investment vehicles;
- mutual, private equity and hedge funds; and
- any similar investment vehicles established with an investment strategy of investing, reinvesting or trading in financial assets.

Consideration should be given to other categories of FI and also to HMRC's August 2014 guidance and their update on holding and treasury companies issued on 21 May.

Reporting

An additional provision in the new regulations indicates that, although service providers may be used for due diligence requirements and reporting obligations, responsibility for them remains with the reporting FI. This makes the responsibility issues easier for agents to take on when assisting clients to comply with IGA and CRS, although agents will have some form of duty to their client.

HMRC's online reporting system is relatively simple. Agents can create an HMRC FATCA account, although they will need to include at least one FI in that account. If the data for a reporting FI is relatively small, the information can be entered manually. However, there are facilities for downloading HMRC's FATCA schema to create separate reports or upload the data in an externally prepared file. The online HMRC reporting system will be modified to accept reports due under CRS and DAC in the future.

Further information

Read Stephen Coleclough's article 'Attention all trusts' from the October 2014 issue of *Tax Adviser*.