COMMON REPORTING STANDARDS AND ITS IMPACT ON FUND MANAGERS

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Introduction

For many years countries around the world have been engaging in the automatic exchange of information in order to tackle offshore tax evasion and other forms of noncompliance. The Common Reporting Standard (**"CRS"**) is an information standard for the automatic exchange of information (AEOI). It is developed in the context of the Organisation for Economic Co-operation and Development (**"OECD"**) in response to the G20 request and approved by the OECD Council on 15 July 2014. Essentially, the CRS provides a standardised set of detailed due diligence and reporting rules for financial institutions to follow to ensure consistency in the scope and quality of information exchanged between participating countries. As highlighted in the 2012 OECD report to the G20, automatic exchange of information is widely practised and is a very effective tool to counter tax evasion and to increase voluntary tax compliance. This article discusses the impact of CRS on Singapore from a funds perspective and some practical followups in relation to the implementation of CRS.

What is CRS? What does it cover?

The CRS calls on jurisdictions to obtain information from their financial institutions and automatically exchange that information with other jurisdictions on an annual basis. It sets out the financial account information to be exchanged, the financial institutions that are required to report, the different types of accounts and taxpayers covered, as well as common due diligence procedures to be followed by financial institutions

Currently, over 90 jurisdictions have committed to exchange information under the CRS and a group of over 40 countries have committed to the early adoption of CRS, with the first data exchanges taking place in September 2017. Singapore has however opted for a late adoption of the CRS and hence the first information exchange is expected to take place by September 2018, with first steps to enable such reporting to be implemented in January 2017.

Under the CRS, Singapore-based financial institutions will be required to report to the local tax authority, the Inland Revenue Authority of Singapore (**"IRAS"**), financial information on the reportable accounts of reportable persons which are tax resident in other participating jurisdictions. IRAS will then exchange that information with other participating jurisdictions on an annual basis.

Financial institutions are defined as custodian institutions, depository institutions, investment entities, or specified insurance companies in the CRS and therefore includes banks, custodians, brokers, certain collective investment vehicles and insurance companies. From a funds perspective, reporting financial institutions includes those businesses undertaking asset management or financial services for or on behalf

of a customer or whose gross income is primarily attributable to investing, reinvesting, or trading in financial assets, if the entity is managed by another financial institution.

The **financial information** that is to be reported by financial institutions relates to all types of financial assets, which includes investment income, account balances and the proceeds of the sale of financial assets (i.e. any interest in a security, partnership interest, commodity swap, insurance contract or annuity contract) in respect of reportable accounts. Information to be exchanged includes the name, address, Taxpayer Identification Number (TIN) and date and place of birth of each reportable person; the account number; the name and identifying number of the reporting financial institution; and the account balance or value as of the end of the relevant calendar or, if the account was closed during such year or period, the closure of the account.

Reportable accounts refer to, broadly speaking, accounts held by individuals and entities that are reportable persons and passive nonfinancial entities with controlling persons that are reportable persons. **Reportable persons** are investors (or beneficial owners) resident in any other participating CRS jurisdiction and the reporting requirements are based on the tax residency of the reportable person.

What is the impact on Singapore?

Introducing new procedures

Financial institutions will need to develop systems to review their existing customer base and introduce new client onboarding procedures to identify reportable accounts. They will also have to establish reporting systems to capture the required information and report it to IRAS. It remains to be seen whether Singapore will require domestic financial institutions to report information for all exchanging jurisdiction account holders together, or if they must separate them by the country of tax residence of account holders.

In order to achieve the aims of CRS, financial institutions will require stronger processes and automated IT for due diligence, monitoring customer data, identifying reportable events, reporting and responding to authorities' requests for information. Reporting formats must be standardised for quick and efficient processing in a cost-effective manner. There must also be a legal instrument providing for information exchange between the jurisdictions and measures to ensure the highest standards of confidentiality and data safeguards. In view of the new procedures involved, Finance Minister Tharman Shanmugaratnam responded in parliament that the Government is mindful that implementing the CRS will impose costs on Singapore's financial institutions and government agencies.

Identifying and reporting accounts

More participating countries means more accounts/account holders requiring due diligence and reporting. When Singapore implements the CRS, it will not only bring in due diligence and reporting rules for its financial institutions but will also enter into bilateral or multilateral CAA agreements with other countries.

Those other countries will be reportable countries with respect to Singapore, the implementing (or participating) country. Therefore, financial institutions in Singapore will have to identify and report accounts held by residents of those reportable countries and by passive entities with controlling persons that are residents of those reportable countries.

When implementing the CRS, the Singapore government could choose to take the 'big bang' approach and enact the CRS in a way that allows financial institutions to review their existing customers and change their onboarding procedures all at once. While the 'big bang' approach would reduce customer contact and implementation costs for financial institutions, it may raise privacy or data protection issues in some countries. Singapore may also adopt the alternative approach and require a review of existing accounts and identification of new accounts only for reportable countries. This would call for additional review and onboarding changes each time a new country is added to the list of reportable countries.

Different reporting obligations across jurisdictions

The CRS will become part of the local law of each participating country. Therefore, a Singapore financial institution's reporting obligation is determined by Singapore law and not by the laws of the reportable country (i.e. the country of residence of the account holder). When determining their obligations, however, financial institutions with a presence in more than one participating country will have to look to the local legislation of each participating country. The CRS poses challenges for fund managers as funds may be required to conduct due diligence to identify financial accounts held directly or indirectly by residents in a large number of participating jurisdictions. Where a fund range includes funds resident in different participating jurisdictions, managers will need to contend with differences in interpretation of the CRS that may be applied by each jurisdiction. It is also worth noting that although Singapore opted for a late adoption of the CRS, Singapore-based fund managers with investment funds domiciled in early adopter jurisdictions, such as the Cayman Islands, are reminded of such jurisdiction's earlier implementation timeframes of 2016 and 2017.

Multiple data exchange regimes in parallel

Singapore financial institutions are currently already under the obligations of the Foreign Account Tax Compliance Act (**"FATCA"**) to submit to IRAS required information in relation to every US reportable account. Because of the differences between FATCA and the CRS (the CRS requires financial institutions to collect and remit more accounts, with additional information to be reported), financial institutions may not be able to use the same due diligence and reporting systems for both standards.

For instance, under FATCA, pre-existing accounts under US$50,000 are excluded from review and reporting, if elected by the financial institution. For many institutions, this de minimis exception eliminates the vast majority of their accounts from review and in some instances means that the entity is not a financial institution for the purposes of FATCA.

The CRS does not have the minimum US$50,000 threshold, and thus all of a financial institution's accounts are subject to review and potential reporting. This, combined with the fact that the review must be done with respect to all reportable countries (and not just for US accounts), means that financial institutions will have to collect and remit information on many more accounts under the CRS than under FATCA. Given this higher volume, some financial institutions that have implemented manual review processes for FATCA will not be able to use these same procedures for the CRS. Because many more accounts may be reportable under the CRS, greater automation of the reporting function would be required. In addition, when implementing the CRS, governments should take into account the burden of duplicative reporting regimes, and consult with local financial institutions on the best way forward.

Practical follow-ups

Since investment funds (including private equity funds and hedge funds) based in Singapore will be classified as reporting financial institutions for the purposes of CRS, such funds will have to perform some practical follow-ups in relation to CRS.

Fund managers have to ensure that their offering documents and other marketing materials include suitable disclosure and risk warnings regarding the requirement to report investors' information pursuant to CRS. Also, any subscription documents and distribution agreements have to be updated, firstly, to ensure that the information required to comply with CRS is collected with effect from the implementation date of CRS in Singapore, and secondly, to ensure that the fund has the right to require investors to provide such other information as may be required. Fund managers will also have to engage with their administrators or such other service providers who will be instructed to perform the additional due diligence and reporting required by CRS. If there are existing FATCA service agreements, it will most likely involve amending or extending the scope of these existing agreements.

Conclusion

Given the broad scope of the change introduced by the CRS, both financial institutions and nonfinancial entities alike should seek professional advice to ensure compliance with the CRS.