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The Mandatory Disclosure Rules for CRS Avoidance Arrangements and Opaque Offshore Structures: Caveat Consiliario

Damien Rios*

The author of this article explains the mandatory disclosure rules for Common Reporting Standard avoidance arrangements and Opaque Offshore Structures.

THE COMMON REPORTING STANDARD

On July 15, 2014, the Organisation for Economic Co-Operation and Development ("OECD") published the Standard for Automatic Exchange of Financial Account Information in Tax Matters ("SAEFAITM"), which contains the Model Competent Authority Agreement ("Model CAA") and the Common Reporting Standard ("CRS"). In the introduction of the SAEFAITM, the OECD stated:

> As the world has become more globalised it is easier for all taxpayers to make, hold and manage investments through financial institutions outside of their country of residence. Vast amounts of money are kept offshore and go untaxed to the extent that taxpayers fail to comply with tax obligations in their home jurisdiction. Offshore tax evasion is a serious problem for jurisdictions all over the world. . . . Co-operation between tax administrations is critical in the fight against tax evasion and in protecting the integrity of tax systems. A key aspect of that co-operation is exchange of information.[1]

The Model CAA and CRS created a blueprint for bilateral reciprocal agreements among participating jurisdictions, with the emphasis on an automatic exchange of financial information with respect to persons who are tax residents of the participating jurisdictions. With 110 jurisdictions adopting or committing to adopt CRS, CRS became the first "world-wide" system of automatic exchange of financial information. Fifty-five jurisdictions adopted

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[1] Page 9, Standard for Automatic Exchange of Financial Account Information in Tax Matters, OECD 2014.

CRS in 2014 and started reporting information in 2017. Forty-six more jurisdictions started reporting in 2018. The United States is noticeably absent from the list of CRS jurisdictions.

Despite the wide scope of CRS, professional advisors were able to design and implement arrangements that permitted their clients to circumvent the CRS disclosure rules. In 2017, the OECD began exploring ways to obtain information about arrangements designed to avoid the reporting requirements of CRS.

MODEL MANDATORY DISCLOSURE RULES

On March 8, 2018, the OECD issued Model Mandatory Disclosure Rules ("Model MDR") for CRS Avoidance Arrangements and Opaque Offshore Structures. The primary intention of the Model MDR is "to target Intermediaries that are responsible for the design, promotion or implementation of CRS Avoidance Arrangements and Opaque Offshore Structures."[2] In general terms, Intermediaries are people or entities who either promote or provide services, assistance or advice in connection with the design, marketing, implementation or organization of CRS Avoidance Arrangements or Opaque Offshore Structures. The Model MDR imposes an obligation upon Intermediaries to disclose substantial information about their clients who use CRS Avoidance Arrangements or Opaque Offshore Structures, described below, to the extent that the information is "within the knowledge, possession or control of the person providing the disclosure."[3]

CRS AVOIDANCE ARRANGEMENTS

The definition of CRS Avoidance Arrangements is extremely broad and far reaching. A CRS Avoidance Arrangement includes any "agreement, scheme, plan or understanding, whether or not legally enforceable"[4] for which it is reasonable to conclude that it is designed to circumvent or is marketed as circumventing the CRS rules.[5] The definition of CRS Avoidance Arrangement also includes any "agreement, scheme, plan or understanding, whether or not legally enforceable" that has the effect of circumventing the CRS rules, even if it was not created for that purpose. The broad definition encompasses bona fide arrangements that are entered into without regard to CRS avoidance, if the

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[2] Page 41, paragraph 83 of the Model MDR.

[3] Rule 2.3 of the MDR.

[4] Rule 1.4(a) of the Model MDR.

[5] Rule 1.1 of the Model MDR.

result of the transaction is that one or more participants avoid the CRS requirements. The Model MDR provides seven examples of CRS Avoidance Arrangements.

The first example is the use of an account, product or investment that does not fall within the technical definition of an account that must be reported under CRS, but which has features that are substantially similar to reportable accounts.[6] This could apply to financial derivative instruments that have the same features of a reportable account but do not fall within the technical definition of a reportable account.

The second example is the transfer of a reportable account, reportable asset or money to a financial institution that is not required to report under CRS or to a jurisdiction that does not exchange CRS information with all jurisdictions of which the individual is a tax resident.[7] This would apply to a transaction as benign as transferring money from a bank located in a CRS member jurisdiction to a bank organized under the laws of, and located in, the United States.

The United States is not a CRS member jurisdiction and financial institutions organized under the laws of, and located in, the United States are not subject to CRS rules, unless they have a nexus to a CRS member jurisdiction that would otherwise make them subject to the CRS rules. Consequently, the aforementioned transfer of funds would be a CRS Avoidance Arrangement.

The third example is the conversion of a reportable account, or money or assets held in a reportable account, to an account that is not reportable under CRS.[8]

The fourth example is the conversion of a financial institution that is required to report under CRS into a financial institution that is not required to report under CRS or into a financial institution located in a jurisdiction that does not exchange CRS information with all jurisdictions of which the individual is a tax resident.[9]

The fifth example is exploiting weaknesses in the due diligence procedures used by financial institutions to correctly identify (1) the account holder and/or

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[6] Rule 1.1(a) of the Model MDR.

[7] Rule 1.1(b) of the Model MDR.

[8] Rule 1.1(c) of the Model MDR.

[9] Rule 1.1(d) of the Model MDR.

the person controlling the account, or (2) all of the tax residences of the account holder and/or the person controlling the account.[10]

The sixth example is allowing an entity to qualify as an Active Non-Financial Entity,[11] which is not subject to disclosure or reporting obligations under CRS with respect to its "Controlling Persons,"[12] allowing someone to make an investment through an entity without triggering a reporting obligation, or allowing a person to avoid being treated as a "Controlling Person" and, consequently, avoid being classified as a reportable taxpayer.[13]

The seventh example is classifying a payment made for the benefit of a person who owns or controls a reportable account as a payment that is not reportable.[14] For example, any arrangement that uses a financial account held in a foreign jurisdiction that is not subject to CRS is a CRS Avoidance Arrangement.[15] This example appears to apply to a person opening an account with a bank in the United States that is not subject to the CRS reporting requirements.

The broad definition of a CRS Avoidance Arrangement encompasses bona fide arrangements that are entered into even if the parties to the transaction were not concerned with CRS avoidance if the arrangement has the effect of avoiding the CRS rules. As discussed above, the definition of a CRS Avoidance Arrangement would apply to a transaction as benign as transferring money from a bank located in a CRS member jurisdiction to a bank organized under the laws of, and located in, the United States.

A commonly used estate planning technique can further illustrate broad scope of the Model MDR. The use of trusts by citizens and residents of the United States is commonplace. Trusts offer numerous benefits, such as asset

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[10] Rule 1.1(e) of the Model MDR.

[11] The definition of an Active Non-Financial Entity under CRS is lengthy and beyond the scope of this article. In general terms, a Non-Financial Entity refers to an entity that is not a financial institution. Financial Institutions include, but are not limited to, banks and other institutions that hold depository accounts, certain insurance companies and some investment entities.

[12] "The term 'Controlling Persons' means the natural persons who exercise control over an Entity. In the case of a trust, such term means the settlor(s), the trustee(s), the protector(s) (if any), the beneficiary(ies) or class(es) of beneficiaries, and any other natural person(s) exercising ultimate effective control over the trust, and in the case of a legal arrangement other than a trust, such term means persons in equivalent or similar positions." CRS Section VIII D.6.

[13] Rule 1.1(f) of the Model MDR.

[14] Rule 1.1(g) of the Model MDR.

[15] Rule 1.1(b) of the Model MDR.

protection, tax efficiencies, succession planning, rules for the orderly distribution of trust assets over multiple generations, and consolidated management of a family's wealth. A person who is resident in a country that does not recognize trusts could elect to create a trust under the laws of the United States. However, since the United States is not a CRS member jurisdiction, if a person who is a tax resident of a CRS member jurisdiction were to transfer reportable assets (e.g., cash held in a bank located in a CRS member jurisdiction) to a trust created under the laws of the United States, the effect would be to place the assets owned by the trust and held in the United States beyond the grasp of CRS. Consequently, that arrangement would fall under the definition of a CRS Avoidance Arrangement. The attorney who drafted the trust could be required to file a disclosure pursuant to the Model MDR with respect to the trust structure, including information about the settlor, trustee, trust beneficiaries, trust protectors, and anyone exerting control over the trust.

Although the initial advice given by a U.S. attorney to a client with respect to a trust may be protected by the attorney-client privilege, the disclosure of any information to a third-party would most likely nullify that protection. Consequently, when the trust agreement is given to the trustee for review and execution, the information contained in the trust instrument, including the identity of the settlor, beneficiaries, trust protectors, the property transferred to the trust and anyone exerting control over the trust, would most likely not be protected by the attorney-client privilege.

If the attorney is not required to disclose the information pursuant to MDR, perhaps because the attorney has no nexus to the CRS member jurisdiction that would trigger the reporting requirement by the attorney, then the burden to disclose the information could fall upon the trustee. The trustee would be an Intermediary with respect to the arrangement, because the trustee would be providing services in connection with the implementation of the trust. If none of the attorney, the trustee, or any other Intermediary, is required to make the disclosures pursuant to MDR with respect to the arrangement, then the onus would fall upon the client.

An arrangement is not a CRS Avoidance Arrangement solely because it results in non-reporting under the CRS rules, if it is reasonable to conclude that the non-reporting does not undermine the policy intent of the CRS rules.[16] The commentary to the Model MDR suggests that this exception applies solely to arrangements that were deliberately excluded from the CRS rules. For example, real estate is an asset class that is not intended to be in the purview of

[16] Rule 1.1 of the Model MDR.

CRS. Consequently, withdrawing money from a financial account that is subject to CRS reporting in order to purchase a residence would not be a CRS Avoidance Arrangement in the absence of any facts or circumstances that would suggest that the transaction was entered into as part of a scheme to avoid CRS.

The commentary to the Model MRD also states that the fact that an Arrangement is a CRS Avoidance Arrangement will not, on its own, make that arrangement subject to disclosure by the Intermediary under these Model MDR. There must be an Intermediary operating within a jurisdiction that is either responsible for the design or marketing of the arrangement or that provides Relevant Services and can reasonably be expected to know that the arrangement is a CRS Avoidance Arrangement.

OPAQUE OFFSHORE STRUCTURE

In general terms, an Opaque Offshore Structure is an offshore structure that is designed to, or marketed as being able to, allow a natural person to be the beneficial owner of a legal person or arrangement while not allowing the accurate determination of the natural person's beneficial ownership of the legal person or arrangement.[17] The definition applies only if the legal person or arrangement does not carry on a substantive economic activity supported by adequate staff, equipment, assets and premises in the jurisdiction where it is established or is taxed as a resident.[18] The definition of an Opaque Offshore Structure does not include a legal person or arrangement "(i) that is an Institutional Investor[19] or that is wholly-owned by one or more Institutional Investors, or (ii) where all Beneficial Owners of that Legal Person or Legal Arrangement are only resident for tax purposes in the jurisdiction of incorporation, residence, management, control and establishment (as applicable) of the Legal Person or Legal Arrangement."[20]

These types of arrangements include, but are not limited to, (1) arrangements that use nominee shareholders with undisclosed nominators, (2) arrangements that use indirect control of an entity or financial structure

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[17] Rule 1.2(d) of the Model MDR.

[18] Rule 1.2(d) of the Model MDR.

[19] Rule 1.4(f) of the Model MDR defines "Institutional Investor" as a legal person or legal arrangement (i) that is regulated as a bank (including a depositary or custodial institution), insurance company, collective investment vehicle or pension fund; (ii) the shares or interests of which are regularly traded on an established securities market; (iii) that is a government entity, central bank, international or supranational organization; or (iv) a legal person or legal arrangement wholly-owned by one or more of the foregoing.

[20] Rule 1.2(c) of the Model MDR.

without formal ownership of the entity or structure, (3) giving someone access to assets held by, or income derived from, a structure without identifying that person as the beneficial owner of the structure, (4) the use of a legal person in jurisdictions where there is no requirement to keep basic ownership information (such as the name of current shareholders) that is accurate and up to date, or (5) using legal arrangements organized under the laws of a jurisdiction that do not require the trustees to hold or obtain adequate, accurate and current beneficial ownership of the arrangement.[21]

INTERMEDIARIES

The Model MDR defines two categories of persons who are "Intermediaries." The definition includes any person responsible for the design or marketing of a CRS Avoidance Arrangement or Opaque Offshore Structure.[22] The definition also includes any person that provides assistance or advice with respect to the design, marketing, implementation or organization with respect to a CRS Avoidance Arrangement or Opaque Offshore Structure ("Relevant Services")[23] if the person providing such services could reasonably be expected to know that the purpose of the arrangement or structure was to avoid CRS, based on the person's actual knowledge of readily available information and the degree of the person's expertise and understanding required to provide the Relevant Services.[24]

The Model MDR requires any person who is an "Intermediary" with respect to a CRS Avoidance Arrangement or Opaque Offshore Structure to disclose that arrangement or structure to the tax authorities in the Intermediary's jurisdiction if the Intermediary (1) makes the CRS Avoidance Arrangement or Opaque Offshore Structure available for implementation through a branch located in the jurisdiction, (2) provides Relevant Services through a branch located in the jurisdiction, (3) is resident or has its place of management in the jurisdiction, or (4) is incorporated in, or established under the laws of, the jurisdiction.[25] Thus, for example, a U.S. lawyer who provides advice in a London branch office to a client who is a tax resident of a CRS member jurisdiction with respect to an Opaque Offshore Structure would be an Intermediary for purposes of the Model MDR, and consequently, would be required to make the disclosures. U.S. legal, tax and other advisors who provide

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[21] Rule 1.2(d)(i)-(v) of the Model MDR.

[22] Rule 1.3(a) of the Model MDR.

[23] Rule 1.4(k) of Model MDR.

[24] Rule 1.3(b) of the Model MDR.

[25] Rule 2.1 of the Model MDR.

advice to clients through a branch located in a CRS member jurisdiction should be cognizant of their MDR disclosure requirements, since some common planning transactions recommended by U.S. advisors may be treated as CRS Avoidance Arrangements or Opaque Offshore Structures.

TIMING OF DISCLOSURE

The disclosures that are required by an Intermediary must be made within 30 days after the Intermediary (1) makes the CRS Avoidance Arrangement or Opaque Offshore Structure available for implementation or (2) provides Relevant Services.[26] The disclosure must be made by the Intermediary with respect to any person who requests the Intermediary to make the arrangement or structure available, or to whom the Intermediary made the arrangement or structure available for implementation, regardless of whether or not the person has implemented the arrangement or structure.[27]

In some instances, discussed below, no Intermediaries will be required to make the necessary disclosures. Under those circumstances, the client must make the disclosure within 30 days after the first step of the CRS Avoidance Arrangement or Opaque Offshore Structure has been implemented.[28]

WHERE TO DISCLOSE

An Intermediary must disclose the structure of the CRS Avoidance Arrangement or Opaque Offshore Structure to the taxing authority in which the Intermediary made the arrangement or structure available. An Intermediary must disclose the structure of the CRS Avoidance Arrangement or Opaque Offshore Structure to the taxing authority in which the Intermediary provided Relevant Services. Disclosure is also required in the jurisdiction where the Intermediary is a resident or has its place of management. Lastly, the Intermediary must disclose the arrangement or structure in the jurisdiction where the Intermediary was incorporated or established. The Model MDR contains rules to prevent disclosures in multiple jurisdictions. Those rules are discussed below.

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[26] Rule 2.2 of the Model MDR.

[27] Rule 1.4(d) defines "Client" as "any person who requests an Intermediary to, or on whose behalf, or for whose benefit, the Intermediary: (i) make(s) a CRS Avoidance Arrangement or Opaque Offshore Structure available for implementation; or (ii) provides(s) Relevant Services in respect of a CRS Avoidance Arrangement or Opaque Offshore Structure." Under the definition, the mere request to make a CRS Avoidance Arrangement or Opaque Offshore Structure makes an individual a "Client" for purposes of MDR.

[28] Rule 2.6(c) of the Model MDR.

INFORMATION REQUIRED TO BE DISCLOSED BY INTERMEDIARIES

Intermediary and Client Information

The Intermediary must disclose its name, address, tax jurisdiction and tax identification number.[29] The Intermediary must also disclose that information about, and the date of birth of, any person for whom the Intermediary provided Relevant Services.[30] This information must be disclosed about any person who requested the Intermediary to make the arrangement or structure available, or to whom the Intermediary made the arrangement or structure available.[31] Rule 2.3(a)(iii) of the Model MDR states that the Intermediary must specify if any such person has actually used the CRS Avoidance Arrangement or Opaque Offshore Structure,[32] implying that the Intermediary must disclose information about potential users who have not implemented the arrangement or structure. The commentary to MDR states that an Intermediary is not required to disclose information about a potential user simply because the potential user attended a presentation about or received marketing materials about a CRS Avoidance Arrangement or Opaque Offshore Structure.

With respect to an Opaque Offshore Structure, the Intermediary must disclose the name, address, tax jurisdiction and tax identification number of the beneficial owner.[33]

Lastly, the Intermediary must disclose the name, address, tax jurisdiction and tax identification number of any other Intermediaries with respect to the CRS Avoidance Arrangement or Opaque Offshore Structure.[34]

Details About the Arrangement or Structure

In addition to disclosing information about the Intermediaries and clients, an Intermediary who is required to make a disclosure under the Model MRD must also provide information about the CRS Avoidance Arrangement or Opaque Offshore Structure. Specifically, with respect to a CRS Avoidance Arrangement, the Intermediary must provide the taxing authority with a description of the features of the arrangement that are designed to have, are

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[29] Rule 2.3(a)(i) of the Model MDR.

[30] Rule 2.3(a)(ii) of the Model MDR.

[31] Rule 2.3(a)(ii) of the Model MDR.

[32] Rule 2.3(a)(iii) of the Model MDR.

[33] Rule 2.3(a)(iii) of the Model MDR.

[34] Rule 2.3(a)(iv) of the Model MDR.

marketed as having, or have the effect of, circumventing CRS.[35] With respect to an Opaque Offshore Structure, the Intermediary must provide the taxing authority with a description of the features of the structure that have the effect of not allowing the accurate determination of the beneficial owner of the structure.[36]

Availability

Lastly, the Intermediary must disclose the jurisdiction or jurisdictions where the CRS Avoidance Arrangement or Opaque Offshore Structure has been made available for implementation.[37]

Disclosure of Transactions Entered into Before the MDR Effective Date

With respect to any CRS Avoidance Arrangement or Opaque Offshore Structure that was implemented on or after October 29, 2014, but before the effective date of MDR in a particular jurisdiction, the promoter of the arrangement or structure must make the required disclosures within 180 days of the effective date of MDR in that jurisdiction.[38] The promoter is not required to make disclosures with respect to any reportable accounts that had an aggregate balance or value of less than $1,000,000 immediately prior to implementing the CRS Avoidance Arrangement or Opaque Offshore Structure.

EXCEPTION TO DISCLOSURE BY INTERMEDIARY

Professional Secrecy Rules

An Intermediary will not be required to disclose any information that is protected from disclosure under professional secrecy rules under domestic law, but "only to the extent the disclosure would reveal confidential information held by an attorney, solicitor or other admitted legal representative with respect to the client."[39] Under these circumstances, the reporting obligation falls upon the client, and the Intermediary must give the client written notice of the client's disclosure obligations.[40] The client must make the disclosure within 30 days after the first step of the CRS Avoidance Arrangement or Opaque Offshore

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[35] Rule 2.3(b)(i) of the Model MDR.

[36] Rule 2.3(b)(ii) of the Model MDR.

[37] Rule 2.3(c) of the Model MDR.

[38] Rule 2.7(a) of the Model MDR.

[39] Rule 2.4(a) of the Model MDR.

[40] Rules 2.4(b) and 2.6(a) of the Model MDR.

Structure has been implemented.[41] The client will not be required to make the disclosure if the client has documentation from the Intermediary showing that the Intermediary disclosed the information to the tax authority of another CRS member jurisdiction under mandatory disclosure rules that are substantially similar to CRS.[42]

Although not contained in the Model MDR, the commentary to the Model MDR suggests that the disclosure rules imposed on a client would not be applicable to the extent that the laws of the relevant jurisdiction provide protection against self-incrimination.[43] Paradoxically, this exception to the disclosure rule appears to exempt taxpayers who reside in a jurisdiction that allows protection against self-incrimination and who implement an unlawful CRS Avoidance Arrangement or Opaque Offshore Structure, which would trigger the protection against self-incrimination, but not those who have implemented legal CRS Avoidance Arrangement or Opaque Offshore Structure, which presumably would not implicate the protection against self-incrimination.

Previously Disclosed Information

The Model MDR contains rules designed to prevent multiple disclosures with respect to the same CRS Avoidance Arrangement or Opaque Offshore Structure. An Intermediary is not required to disclose any information under the Model MDR if the Intermediary has documentation demonstrating that the required information was already disclosed to the appropriate tax authority. This rule includes disclosures that were properly made to taxing authorities in other CRS member jurisdictions in which the Intermediary has a branch office and made the CRS Avoidance Arrangement or Opaque Offshore Structure available, or from which the Intermediary provided Relevant Services.[44] The exception to the disclosure rules also applies when an Intermediary has documentation demonstrating that the required information was already disclosed to the tax authority in a CRS member jurisdiction where the Intermediary is resident or has its place of management.

PENALTIES

The Model MDR does not provide for specific penalties for violating the disclosure rules. The commentary states that "mandatory disclosure regimes

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[41] Rule 2.6(c) of the Model MDR.

[42] Rule 2.6(b) of the Model MDR.

[43] Paragraph 86 of the Commentary to the Model MDR.

[44] Rule 2.5(b) of the Model MDR.

should include clear sanctions to encourage disclosure and to penalize those who do not fulfill their obligation."[45] The commentary suggests that jurisdictions consider monetary penalties and non-monetary penalties. This leaves the door open for CRS member jurisdictions to impose criminal penalties when enacting the Model MDR.

A WORD OF CAUTION

Although CRS may have a noble goal of curtailing tax evasion by persons who are tax residents of a member jurisdiction, the definition of CRS Avoidance Arrangements and Opaque Offshore Structures are very broad. Advisors should be mindful of triggering CRS reporting requirements under the Model MDR, even when providing their clients with advice or services in connection with seemingly benign strategies that are not intended to avoid CRS reporting requirements.

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[45] Paragraph 89 of the Commentary to the Model MDR.