THE BIG REVEAL

The new Common Reporting Standard being adopted worldwide requires financial institutions to share more information, upending old wealth management strategies.

STORY **RICHARD LORD**

PHOTOGRAPHY **GETTY IMAGES**

If you think your tax affairs are complicated now, please take a deep breath. They might well be about to get more complicated – a little bit more complicated for some people, and a whole lot more complicated for others. The reason is a new international system of information exchange between banks and tax authorities, the Standard for Automatic Exchange of Financial Account Information, more commonly known as the Common Reporting Standard (CRS). It means that financial institutions will be forced to report detailed information about a range of assets held by their clients to the tax authorities in any country or other tax jurisdiction that has signed up to the standard; and it mandates that they do this automatically, without being asked.

The CRS was developed by the Organisation for Economic Cooperation and Development (OECD) in collaboration with the G20 group of economically powerful nations and the European Union. Agreed in 2014, originally by 47 countries, it has now been signed by over 100 nations. It will kick in at the start of 2017 for about half of those countries, and at the start of 2018 for the rest, with the first information exchange due to follow by September of the respective year.

Under CRS definitions, reportable information includes not only investment income – interest, dividends and so on – but also account balances and any income from the sale of assets. CRS also specifies the due diligence procedures that financial institutions must use to identify reportable accounts, those held by individuals as well as entities such as trusts and foundations. They must also identify who actually controls these accounts. And financial institutions are defined pretty broadly: banks, obviously, but also brokers, collective investment vehicles and insurance companies.

It means that international tax reporting moves largely from an on-demand system to an automatic one. Hong Kong, for example, currently has treaties with 37 other tax authorities, so the tax authorities in say, the UK, can demand information on British businesspeople who have accounts in Hong Kong to see if they owe tax on them. At the moment, though, they have to specifically ask for data on a particular individual – which means that if you're hiding something about your tax affairs, you're still hard to find. As Howard Bilton, chairman of wealth management company Sovereign Group, puts it: "Asking for information on demand is not very effective, because you need to know that someone's doing something wrong," adding that he knows of no occasion on which the existing on-demand system has been used to chase down unpaid tax.

Now, with the onus shifted to financial institutions to report to tax authorities, and not just locally, individuals are going to find it a whole lot harder to park their wealth offshore away from the hands of the tax man. "The new system is bound to be more effective," says Bilton. "It will scare... anyone who's non-compliant."

Not all experts agree, however, what the likely impact of the new rules will be: some see it as a relatively benign move that will only have a serious negative impact on people who are trying to hide their assets – and are therefore potentially guilty of a criminal offence – while others see it as an unnecessary move that will needlessly open up more vulnerabilities when it comes to data security and financial privacy.

The good news is that it's unlikely to have much impact on the tax liabilities of Hong Kong

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residents, because the SAR doesn't tax its residents on overseas assets or earnings. "If you're complying around the world, there's no tax downside to this," says Ian Burgess, Brisbane-based tax partner for Big Four accountancy firm EY.

There will, however, be administration issues – ie, a lot of new forms to fill in. "If you're resident in Hong Kong only, the only effect should be administrative," says Bilton. "You shouldn't fear it, but there will be some inconvenience and possibly some cost, although it won't be big for a private banking client. Also, banks are going to be adding another 100 pages or whatever of riders, indemnifying themselves. It's probably going to end up like iTunes, where there are a hundred pages of terms and conditions that no one ever reads. If you need the service you'll sign it; otherwise they'll withdraw banking services."

If you're resident somewhere outside Hong Kong, however, or a dual resident, and you have assets in Hong Kong, the financial implications could be severe. "The CRS are going to affect people who should be subject to tax but haven't been paying it because they've been hiding the existence

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— Howard Bilton, Sovereign Group

of accounts," says Bilton. "We're probably going to have situations where people are paying more tax as well as fines. Tax planning should never rely on people not knowing about your assets, and tax evaders will now be caught. It's always been rubbish; it's now ineffective as well. Everything you do is going to be scrutinised."

There are also implications if you're thinking of moving to another tax domain, says John Barclay, managing director of business consulting firm Primasia. "If you move overseas, you need to be fully advised on the implications of moving there. You could end up spending US$500,000 (HK$3.8m) on an Australian Significant Investor visa and then realise later that there's another US$500,000 in tax liability."

SUNSET OVER PANAMA

In order to have any effect, the CRS need to be integrated into the domestic law of each of the participating nations – and the business of adapting the standards into local law shows just how complex they are. In Hong Kong, for instance, it has resulted in about 100 pages of new official documents detailing their implementation, signed into law in June as the Inland Revenue (Amendment) Bill 2016. The ordinance it amends is only 200 pages long in the first place. Hong Kong, however, will implement the new rules on a bilateral basis, with individual tax treaties, rather than trying to go the full multilateral nine yards.

The number of countries signed up to the CRS, of course, is still nowhere near all of them. The elephant in the room is the US, which already has its own piece of legislation, the Foreign Account Tax Compliance Act, or FATCA. Enacted in 2010, it requires citizens to declare offshore holdings annually. Already states like Delaware, Nevada and Wyoming attract a lot of offshore assets; with the US demanding tax information wherever it wants it. But, by declining to sign up for the CRS and not necessarily reciprocating, those domains are starting to look perilously close to tax havens.

"The US is in some circles becoming the place of choice to set up offshore structures," says Bilton. "They take an interesting view of responsibility: they demand information from everyone else but don't share it themselves."

Closer to home, one of the other tax domains yet to sign up to the CRS is Taiwan. "For people who want [discretion], Taiwan is still discreet," says Barclay. In fact, not only will Hong Kong's Inland Revenue Department not be collecting any additional tax as a result of the new rules; it could even collect less. With cooperation between the Hong Kong and mainland China tax authorities likely to be close, PRC residents with assets in Hong Kong could move them to other jurisdictions – Singapore, perhaps, or Taiwan or the US – so that the PRC tax authorities don't find out about them.

"As both China and Hong Kong will be signing up to CRS, and mainland Chinese will be the most affected as they are one of the largest groups of foreign investors in Hong Kong, the question will be how CRS will apply between China and Hong Kong, since Hong Kong is not a separate country and is part of China." says Vincent Bremmer, Hong Kong managing director of corporate services provider Vistra."

Hong Kong has signed up for the CRS, says William Ahern, principal of law firm Ahern Lawyers, because it wants to stay onside with governments in the west that are keen to be seen cracking down on tax evasion.

"Hong Kong stands to make no money at all from this, so the question is: why are we doing it? We don't want to be labelled uncooperative, or called a tax haven by the Europeans. The worst thing the OECD could do would be to impose sanctions, but I really don't think China is going to let them do that."

The Panama Papers revelations in April this year gave the CRS further impetus by making it hard for financial institutions to demur; the proposals were already pretty well advanced by that time, but then it's been a while since banks were able to take the moral high ground.

"When you think of it from governments' perspective, it's a master stroke," says Ahern. "It transfers responsibility to the banks. They're becoming unpaid tax collectors. Of course the banks are up in arms, but who cares what the banks think these days? They're so happy to hang onto their banking licences that they're not going to complain about a bit more regulation."

And the costs to the banks could be high – although, whether directly or indirectly, they'll probably end up passing quite a lot of it onto their customers.

"The banks are squealing about the compliance cost of having to do this," says Barclay, adding that an employee of a major bank had estimated the internal cost of reviewing an account application for CRS compliance at about HK$20,000. "The fact that they've got people breathing down their necks means that they're a lot more cautious about account opening."

Standardisation of reporting will be an additional headache for financial institutions, because each domain's tax authority could potentially demand a slightly different set of data from each of the others. Quite how it will work is unclear, but there's going to need to be some degree of standardisation – to allow a potentially very

LEFT Howard Bilton, chairman of Sovereign Group

RIGHT Australian Treasurer Joe Hockey (L) with OECD secretary-general Angel Gurria (R) during a press conference at the G20 Finance Ministers and Central Bank Governors Meeting in Cairns on September 20, 2014. Gurria presented to the G20 recommendations on the biggest changes to international tax rules in more than a century, in a bid to tackle corporate tax avoidance.

PHOTOGRAPHY GETTY IMAGES / GARETH GAY (LEFT)

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complex system to work at all, and also, as Ahern says, "to reduce jurisdictional arbitrage".

As well as reporting inconsistencies, the penalty regime will also vary from jurisdiction to jurisdiction, both in its severity and in whether financial institutions and individuals are both deemed responsible.

All this, says Bremmer, "is definitely a complicating factor. Is it going to be consistent across the board? How is it going to be shared, and in what format? They're putting the emphasis on banks – how is that going to work in practice? If they want to start implementing this by 2018, they need to start working on it now. It's an enormous task for banks and other financial institutions to start complying with this, and then you've got to move to the tax authority level. The execution is always more complicated than people expect."

However, adds Burgess, "with tax authorities having to build new systems to exchange and process all this new information, it could be a chance to create more efficient tax regimes." Mainland China, with its comprehensive but somewhat chaotic, non-centralised system, could be one example.

PRIVACY POINTS

A range of professionals other than bankers are involved in planning for the potential impact of CRS, including financial consultants and wealth managers, lawyers and accountants, and naturally some also have objections to CRS. After all, it could have a negative impact on their clients' wealth – although of course it's likely to mean more work for tax advisers themselves. But apart from that, privacy and data security are a major issue for many. Under the CRS, personal and financial data will be held in an exponentially increasing number of places, meaning the risks of a data breach go up, especially as some of them could be tax authorities with relatively lax or inefficient data security controls.

"It's a concern," says Bremmer. "Governments worldwide have a big agenda now to tackle tax evasion and avoidance, and there's always a tension between that and personal privacy. Governments are able to share information without even having reasons for suspicion, and that's a bit scary for the general public."

LEFT
John Barclay, managing director Primasia

RIGHT
Vincent Bremmer, managing director Vistra Hong Kong

COURTESY **PRIMASIA & VISTRA**

PHOTOGRAPHY **DANIEL HO**

ABOVE
William Ahern, principal of law firm Ahern Lawyers

Ahern, who recently advised Hong Kong's Legco against the adoption of the CRS into local law, says the new rules could lead to anything from identity theft to blackmail to kidnapping. "It results in all these unpredictable data pools being created, and by definition they can't be protected because they're digital – with the best will in the world, they can't keep this safe. So some guy in China or Russia can start extorting you. Of course fraud will increase – it's absolutely inevitable. There are so many bad guys out there who want this kind of data."

Many of his clients, Ahern says, have legitimate privacy reasons for wanting to keep certain information secret: "If you're in Hong Kong and you have a bank deposit in the UK through a BVI [British Virgin Islands] company because you wanted privacy, this is going to result in the loss of that company. I have a client in Singapore and they have a trust and their daughter is one of the beneficiaries. The daughter is going to school in the UK next year, and my client rings me up and says: 'can you remove my daughter as a beneficiary? I don't want a piece of paper floating around in the UK saying that my daughter is entitled to US$50 million, with her residential address in London on it'."

For Ahern, another issue results from conflating two types of monetary concern. "The tax authorities are looking for warm bodies, which isn't a tax concept but a money-laundering concept that they're bolting onto tax law. It assumes that everyone who has money outside the country is a tax cheat."

He recommends that people do what they can to avoid undue levels of disclosure. "There are things you can do to reduce your reporting profile. They might be about segregating reportable and non-reportable assets. Take control of the reporting process: with a trust rather than a bank as the reporting entity, it's possible to reduce what's reported. Understand what your obligations are and stick to them, but don't do any more."