FATCA, CRS & Tax Transparency – Can It End the Global Tax Evasion?

Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS) have become important legislations for the governments around the world to exchange the information on financial account on an automatic basis. If FATCA and CRS are implemented and administered in its true letter and spirit, then the 'Panama Papers' leaks, 'The Bahamas' leaks and the recent 'Paradise Paper' leaks may become things of the past as both FATCA and CRS provide for automatic exchange of information amongst the governments. They provide for seamless exchange of information of financial accounts on an annual basis.

Tax evasion is a global problem. The 'Panama Papers' leaks, in April 2016 shocked the entire world as it unfolded the secret financial dealings of the world's rich and powerful. The then US President Barack Obama called for international tax reform in the wake of the revelations contained in the 'Panama Papers'. Further, Obama described the revelations from the leaks as "important stuff" and said the issue of global tax avoidance was a "huge problem". Then came 'The Bahamas' leaks with the details of the offshore activities of prime ministers, ministers, princes and convicted felons. Now the latest scandal which got added to the infamous list is 'Paradise Papers'. Not to digress from the topic, let us understand the tax transparency initiatives taken up by various governments and the OECD.

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FATCA

The Foreign Account Tax Compliance Act (FATCA) is a United States of America (US) federal tax law which promotes cross border tax compliance by implementing an international standard for the automatic exchange of information related to US persons.

FATCA is part of the Hiring Incentive to Restore Employment (HIRE) Act, 2010 and requires that foreign financial Institutions (FFIs) and certain other

non-financial foreign entities (NFFEs) report to the Internal Revenue Service (IRS) information about financial accounts on the foreign assets held by their US account holders, or by foreign entities in which US persons hold a substantial ownership interest. While the key goal is to collate the information about US persons by the local tax authorities/IRS, FATCA imposes tax withholding at 30% where the applicable documentation and reporting requirements are not met.

Inter-governmental Agreements (IGAs)

FATCA raised a number of issues, including that FFIs established in some countries may not be able to comply with reporting, withholding, and account disclosure requirements because of legal restrictions such as foreign privacy and data protection laws. To overcome the legal restrictions, the US developed and entered into IGAs with several countries on FATCA.

The key thing an IGA achieves is to:

- Address the legal barriers to FATCA compliance;
- Make provisions for a reciprocal exchange of information; and
- Simplify some of the requirements, thereby reducing the cost of compliance.

There are two model IGAs developed by the US to implement FATCA. They are:

Model 1 IGA: The Model 1 IGA would require FFIs to report all FATCA related information to their local tax authorities, which would then report the FATCA related information to the IRS. The local tax authorities would then report the FATCA related information to the US IRS annually. Further, the Model 1 IGA takes two forms – reciprocal and non-reciprocal.

- The Model 1A IGA is reciprocal, requiring the US to provide certain information relating to residents of the FATCA Partner country to the government agency in that country. The FATCA Partner country will also provide FATCA related information to the US.
- The Model 1B IGA is non-reciprocal meaning that the FATCA related information is provided by the FATCA Partner country to the US. However, no information is sent from the US to the FATCA Partner country.

Model 2 IGA: The Model 2 IGA would require FFIs to report information directly to the IRS. Under such an IGA, FFIs will need to register with the IRS, and certain FFIs will sign a version of the FFI agreement modified to reflect the IGA.

Status of IGAs

As of March 2018[1], 113 countries signed (or reached an agreement in substance) the IGAs with the US. While 99 countries signed (including 10 countries which reached an agreement in substance) the Model 1 IGAs, remaining 14 countries signed (including 3 countries which reached an agreement in substance) the Model 2 IGAs.

CRS

Common Reporting Standard (CRS) was initiated by the Organisation for Economic Co-operation and Development (OECD). It is a global tax reporting standard for the automatic exchange of information (AEoI). CRS requires the financial institutions to report the offshore financial assets and details to other CRS participating jurisdictions. In simple terms, CRS requires the financial institutions (FIs) to collect and report information in respect of non-resident accounts to other CRS participating jurisdictions on a yearly basis.

Status of CRS

As of March 2018[2], 146 jurisdictions committed to exchanging information with each other under the CRS, exchange relationships between jurisdictions are typically based on the multilateral Convention on Mutual Administrative Assistance in Tax Matters (Convention).

The Convention is the most comprehensive multilateral instrument available for all forms of tax co-operation to tackle tax evasion and avoidance, a top priority for all countries and 117 countries have already committed to share the information on residents' financial assets and incomes in conformation with the CRS.

Further, 98 countries have already signed the CRS Multilateral Competent Authority Agreement (CRS MCAA) on Automatic Exchange of Financial Account Information. The CRS MCAA specifies the details of what information will be exchanged

[1] Source: www.irs.gov
[2] Source: www.oecd.org

and when. It is interesting to note that the US has not signed the CRS MCAA and indicated that it is undertaking automatic information exchanges pursuant to FATCA and hence, from CRS perspective, will be *prima-facie* a non-participating jurisdiction unless otherwise decided by other CRS partner jurisdictions.

Are FATCA and CRS One And The Same?

No, both are different.

Though CRS is similar to FATCA Model 1 IGA in certain aspects, there are major differences between the two. The key difference being the reporting related requirements. While FATCA requires financial institutions to report the financial assets and details of US persons, CRS requires financial institutions to report the financial assets and details of other CRS participating jurisdictions.

Applicability of FATCA and CRS in India

On July 9, 2015[3], India signed the IGA with the US (India-US IGA), for improving international tax compliance and implementing the FATCA. India signed the Model 1A IGA which means that the agreement is reciprocal in nature. The Indian FIs will provide necessary information to the Indian tax authorities, which will then be transmitted to the US on an annual basis. Under the India-US IGA, US will also provide substantial information about Indians having financial assets in the US.

To combat the problem of offshore tax evasion and avoidance and stashing of unaccounted money abroad requiring co-operation amongst tax authorities, India signed the CRS MCAA on June 3, 2015, to automatically exchange information based on Article 6 of the Convention. The CRS requires the financial institutions of the "source" jurisdiction to collect and report information to their tax authorities about account holders "resident" in other countries, such information having to be transmitted "automatically" on yearly basis.

Further, Government of India made necessary amendments to The Income Tax Rules, 1962 (Rules) vide notification dated August 7, 2015 and added Rules 114F to 114H for operationalisation of India-US IGA/ FATCA and CRS which became effective from August 31, 2015.

The information regarding US reportable persons and other reportable persons have to be furnished in form 61B annually.

Life Cycle of FATCA and CRS

It is important to first identify and classify the entity either as 'Financial Institution' (FI) or 'Non-financial Entity' (NFE).

FI means a custodial institution, a depository institution, an investment entity, or a specified insurance company. NFE is defined to mean any entity that is not a financial institution. NFE could be either Active NFE or Passive NFE[4].

In the Indian context, the compliance obligations and the related provisions imposed by the India-US IGA read with the Rules and implementing regulations apply to any entity that is a Reporting Financial Institution (RFI). The RFI is defined to mean any Indian financial institution that is not a Non-Reporting Financial Institution (NRFI). NRFI is not required to maintain or report the information, except in case of "financial institution with a local client base" in certain specified situations. These NRFIs are listed in Annex II of the India-US IGA and Indian FATCA Rules.

Once the entity is classified as a FI, then such a FI needs to get itself registered (unless exempted as mentioned above) with the US Internal Revenue Service (IRS) and obtain Global Intermediary Identification Number (GIIN). There are further obligations, among other things, to conduct detailed due diligence procedures, withholding and reporting of US reportable accounts (as per the India-US IGA) and other reportable accounts (as per the CRS), on an annual basis.

GIIN

GIIN is an abbreviation of Global Intermediary Identification Number. The US IRS allots and approves the GIIN to the FIs, sponsoring entities and certain other entities. These entities where GIIN is assigned, acts a unique number and can use it to identify themselves to withholding agents and tax administrators for FATCA tax forms, self-certification forms and reporting purposes.

The GIIN, formatted as XXXXXX.XXXXX.XX.XXX, is a 19-character identification number made up of several identifiers. These characters will never contain the letter "O".

Country-Wise GIINs

As of March 2018 (Financial Institutions in approval status as on February 22, 2018)1, there are 301,725 FIs registered with the US IRS and obtained GIIN.

[3] The India-US IGA is available at www.incometaxindia.gov.in

[4] Refer to Rule 114F of the Income Tax Rules, 1962, for definitions of FI, NFE, Active NFE, Passive NFE, etc

The country wise GIINs (top 10) are mentioned below:

Cayman Islands	– 55,393
United Kingdom	– 31,168
Brazil	– 21,531
Japan	– 20,681
Luxembourg	– 12,707
British Virgin Islands	– 11,363
Canada	– 10,619
Jersey	– 7,404
Guernsey	– 7,386
France	– 6,942

As of March 2018 (Financial Institutions in approval status as on February 22, 2018), only 2,042 Indian FIs obtained GIINs and is in 26th position in terms of overall GIIN registration with the US IRS.

On Boarding and Due Diligence

RFIs have the onus of performing specified due diligence procedures for the purpose of identifying the US reportable accounts (as per India-US IGA) and other reportable accounts (as per CRS). The India-US IGA and the Rules set out the due diligence procedures and requirement for RFIs in identifying such accounts. The due diligence procedures differ based on the category of the reportable accounts held which could fall under any of the following categories:

(a) Pre-existing Individual Accounts
(b) Pre-existing Entity Accounts
(c) New Individual Accounts
(d) New Entity Accounts

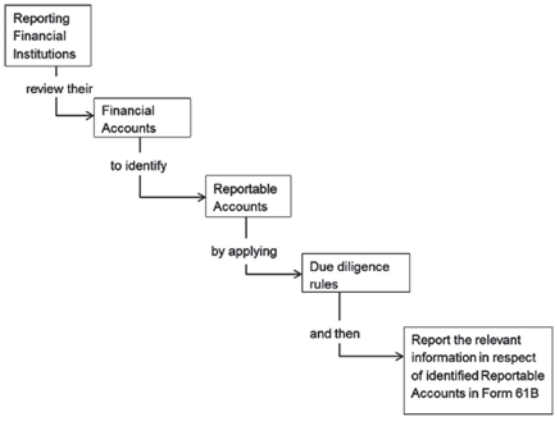
Apart from the above, the due diligence procedure is also dependent on balance/value of the financial account. A Financial account is an account maintained by a financial institution and includes certain categories of accounts as specified in Rule 114F(1) of the Rules.

The due diligence procedures form the crux of the entire FATCA and CRS regulations. The India-US IGA and the Rules provide detailed due diligence procedures for each and every type of reportable accounts. In this regard, the Government of India also issued first detailed Guidance Notes on 31 August 2015 which was updated several times. The fourth and updated Guidance Note was issued on 30 November 2016[5] which acts as a further guidance to help FIs, Regulators and officers of India's Income Tax Department to understand and comply with the reporting requirements under the India-US IGA/ FATCA and CRS.

Reporting

Once the reportable accounts are identified post the due diligence procedures, the RFI shall report the relevant information in Form 61B annually.

In a nutshell, process of Reporting under FATCA and CRS is depicted below[5]:



Accordingly, all the RFIs should register on the related e-filing portal of Income Tax Department as RFI by submitting the requisite details. Thereafter, the reports can be submitted online by using the digital signature of the 'Designated Director' by either uploading the Form 61B or 'NIL' report.

Timelines

The key dates and important timelines (after considering any extensions granted, if any) are summarised below:

Cut-off date prior to which accounts are treated as pre-existing account (both individual and entity) under FATCA	June 30, 2014
Date for considering New Account (both individual and entity) under FATCA	July 1, 2014
FATCA came into force in India	August 31, 2015
First reporting (for calendar year 2014) under FATCA	September 10, 2015
Review of pre-existing individual High Value being US reportable Account as on June 30, 2014	December 31, 2015
Cut-off date prior to which accounts are treated as Pre-existing account (both individual and entity) under CRS	December 31, 2015
Date for considering New Account (both individual and entity) under CRS	January 1, 2016
Second reporting (for calendar year 2015) under FATCA	May 31, 2016

[5] The Guidance Note dated November 30, 2016 is available at www.incometaxindia.gov.in

Review of pre-existing individual Lower Value being US reportable Account as on June 30, 2014	June 30, 2016
Review of pre-existing entity being US reportable account with aggregate balance exceeding USD 250,000 as on June 30, 2014	June 30, 2016
Review of pre-existing individual High Value being other reportable Account as on December 31, 2015	December 30, 2016
Review of pre-existing entity being other reportable account with aggregate balance exceeding USD 250,000 as on December 31, 2015	December 30, 2016
Alternate procedures for individual and entity accounts opened from 1st July 2014 to 31st August 2015	April 30, 2017
For calendar year 2016: First reporting under CRS Third reporting under FATCA	May 31, 2017
Review of pre-existing individual Lower Value being other reportable Account as on December 31, 2015	June 30, 2017
For calendar year 2017: Second reporting under CRS Fourth reporting under FATCA	May 31, 2018

Penalties

The Annual FATCA and CRS report in Form 61B is required to be furnished by May 31 of the following year, to the year of which information is required to be reported.

As per Section 271FA of the Income Tax Act, 1961, failure by the FI to file Form 61B shall be liable to pay INR 500[6] for each such day that the failure continues. In case where the FI has been issued a notice for filing of the statement in Form 61B, a sum of INR 1,000[7] is payable for each such day the failure continues.

If the financial institution provides inaccurate information in Form 61B, then a penalty of INR 50,000 shall be levied.

Tax transparency rules such as FATCA and CRS regulations have far reaching impact on the exchange of information between India and the partner countries. The information collected by India or the partner countries has effectively being used by the respective tax authorities in initiating/ opening tax audits/assessments.

After the 'Paradise Papers' leaks, the Central Board of Direct Taxes (CBDT) quickly issued a statement that the Multi Agency Group (MAG) probing the Panama Papers leak will monitor the probe and take "swift action" on the 'Paradise Papers' on financial holdings abroad that list a number of Indian entities.

Conclusion

Tax transparency rules such as FATCA and CRS regulations have far reaching impact on the exchange of information between India and the partner countries. The information collected by India or the partner countries has effectively being used by the respective tax authorities in initiating/opening tax audits/assessments. The tax authorities will map it with the disclosures and information furnished by the tax payer in his income tax return. Interest, fines, penalties and/or imprisonment to the tax payer in either jurisdiction or multiple jurisdictions may arise in case of non-compliance or contraventions to the provisions of the India-US IGA, Rules and CRS.

Further, the Income Tax Department's recent initiative 'Project Insight' to effectively utilise the vast amount of information at its disposal more effectively to track tax evaders and will also be for effective implementation of Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS).

Next is the trove of millions of records which were pulled out from 'Panama Papers' to 'Paradise Papers' features over thousands of Indians and mega Indian corporate houses linked to offshore firms. After the 'Paradise Papers' leaks, the Central Board of Direct Taxes (CBDT) quickly issued a statement that the Multi Agency Group (MAG) probing the Panama Papers leak will monitor the probe and take "swift action" on the 'Paradise Papers' on financial holdings abroad that list a number of Indian entities. It said the government has directed that investigation in cases of Paradise Papers will be monitored by a re-constituted MAG, headed by the chairman CBDT and having representatives from the CBDT, the Enforcement Directorate, the Reserve Bank of India and the Financial Intelligence Unit.

All the above initiatives if properly implemented, administered and monitored would certainly bring down the global tax evasion and bring in more tax transparency. ■

[6] As per the Union Budget 2018, proposed to be increased from INR 100 to INR 500 for each day of default.
[7] As per the Union Budget 2018, proposed to be increased from INR 500 to INR 1,000 for each day of default.