Offshore Tax Evasion & Compliance: OECD/CRS and FATCA

Part One

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August 2017

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CRS Advisory*- Updated; August 2017*

As many will already know, the automatic exchange of information for tax law enforcement purposes started first in Europe with the EU Savings Tax Directive, went international with the US Foreign Accounts Tax Compliance Act, and, from 2017, went global with the recently agreed; Common Reporting Standard or "CRS". The CRS provides for annual automatic exchange between governments of financial account information. CRS sets out the financial account information to be exchanged, the financial institutions that need to report, the different types of accounts and taxpayers covered, as well as common due diligence procedures to be followed by financial institutions.

Background To The CRS

As an attack against "tax avoidance and evasion" facilitated by tax planning techniques purportedly used by some wealthy individuals and corporations in "tax havens" around the world, the G20 finance ministers endorsed automatic exchange as the new tax transparency standard on April 19, 2013.

On October 29, 2014, 51 jurisdictions (the "early adopters"), 39 of which were represented at ministerial level, signed a multilateral competent authority agreement to automatically exchange information based on Article 6 of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. Subsequent signatures of the agreement, including a signing ceremony on the margins of the OECD Ministerial meeting of June 2015, brought the total number of jurisdictions to 61 (see below). This agreement specifies the details of what information will be exchanged and when.

Countries that have signed up to the CRS will exchange information "automatically" with one another. The financial information to be reported with respect to reportable accounts includes interest, dividends, account balance, income from certain insurance products, sales proceeds from financial assets and other income generated with respect to assets held in the account or payments made with respect to the account.

Reportable accounts include those held by individuals and entities (which includes companies, trusts and foundations), and the standard includes a requirement that financial institutions "look through" passive entities to report on the relevant controlling persons. The financial institutions covered by the standard include custodial institutions, depository institutions, investment entities and specified insurance companies.

What Countries Will Be Subject to CRS

The total number of signatories as at June 4, 2015, was 61, including the following countries and territories:
Albania, Anguilla, Argentina, Aruba, Australia, Austria, Belgium, Bermuda, British Virgin Islands, Canada, Cayman Islands, Chile, Colombia, Costa Rica, Croatia, Curaçao, Cyprus, Czech Republic, Denmark, Estonia, Faroe Islands, Finland, France, Germany, Ghana, Gibraltar, Greece, Guernsey, Hungary, Iceland, India, Indonesia, Ireland, Isle of Man, Italy, Jersey, Korea, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mauritius, Mexico, Montserrat, Netherlands, New Zealand, Norway, Poland, Portugal, Romania, San Marino, Seychelles, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland, Turks and Caicos Islands, and the United Kingdom.

Now over 100 jurisdictions* have committed to sign have endorsed the CRS, and the number is continuing to grow by some signing on effective in 2018. Critically, data began being collected on 1/1/2016 for OECD countries, with 50 countries starting automatic data sharing in 2017, and the balance (notably China and Brazil) coming on line next year. This means that clients with traditional "offshore" structures will forever lose their privacy if they did not restructure their global estate by Dec 31, 2015.
Or, see exceptions below

Pre-Existing Insurance Exception.

The CRS rules, however, provided the following significant exception:

"Accounts Not Required to be Reviewed, Identified, or Reported. A Preexisting Individual Account that is a Cash Value Insurance Contract or an Annuity Contract is not required to be reviewed, identified or reported, provided the Reporting Financial Institution is effectively prevented by law from selling such Contract to residents of a Reportable Jurisdiction."

This was an important carve-out for an otherwise legitimate and compliant financial instrument. Not a loophole, insurance is an "intended result", that is being recognized for what it is; one of the few financial structures that offers substance to the form.

*See: https://www.oecd.org/tax/transparency/AEOI-commitments.pdf)

In terms of policy design, “death benefit only” policies (no-cash value) add significant further protection as there is no account value to report on as defined in the CRS regulations (similar again to FATCA). The goal may therefore be in designing international no-cash value policies with substantial death benefit, to fully satisfy a client’s local applicable tax and insurance rules- and may also be simultaneously US compliant, should a client or his or her beneficiaries/heirs move to the United States.

STRATEGY: Use of a Puerto Rico as a jurisdiction

A number of jurisdictions offer international life insurance that can at the same time qualify as both tax-exempt and not subject to reporting under the CRS regime, but we wanted to focus on one jurisdiction that is uniquely situated to offer reporting relief to not only U.S. policy holders, as it does now, but to the rest of the world given CRS. That jurisdiction is Puerto Rico.

Puerto Rico is a US Commonwealth Territory that offers a progressive legal structure in the context of financial services with offshore-like flexibility but without the “haven” taint.

And, not unlike a number of US States, Puerto Rico has a clearly articulated segregated statute which holds the assets of a policy legally distinct from any other policy- and from the general account assets and liabilities of the insurance company itself. Thus making the assets of such a policy bankruptcy remote, and never at risk to the carrier. Traditional insurance company grading metrics like “A-ratings” are now somewhat irrelevant.

Asset protection is also very often a factor, and Puerto Rico has very clearly articulated laws that prevent any creditor of a policy owner (or policy beneficiary) from attacking a PR issued policy (provided the funding of the policy itself was not a fraudulent conveyance).

From a reporting perspective, as far as the U.S. is concerned U.S. policyholders are exempted from FBAR reporting and PR resident institutions free from FATCA obligations- in that Puerto Rico is a US territory and deemed to be US for this FATCA purposes. Now for *non*-US clients, Puerto Rico as a US Territory is off the CRS grid, as it is not currently, nor likely to be, a direct party to CRS.

Returning then to the focus on insurance itself, life insurers in Puerto Rico are NAIC US and Puerto Rican Regulator supervised. Carriers there are not legally licensed to sell insurance locally in Europe, Canada or Latin America, but the exception seems to be on-point availability given the right fact situations. This therefore presumes policy acquisition by a non-native person or entity e.g. a Chilean national cannot take direct ownership of an international policy.

Given that a policy cannot legally be sold to residents of Chile or potentially other countries that are CRS signees, clients will likely use an entity that acquires and takes ownership of the policy. Assuming so, there may or may not be CRS reporting issues for that entity depending on its domicile.

For clients that already have and wish to maintain companies or trusts in jurisdictions that will be required to make the CRS reporting, the use of a death benefit only (no cash value) policy provides effective CRS protection as the policy has no reporting value for CRS purposes. Thus, if the policy was issued prior to January 2016, the pre-existing insurance contract exception discussed above should apply.

Conclusion.

International private placement variable life insurance policy can compliantly provide lifetime tax deferral and an income tax-free death benefit upon the death of the life insured- under the tax laws of the United States as well as now many other countries around the world. Such a policy also provides ongoing client confidentiality, as the insurance company – rather than the client – is the deemed owner of the underlying policy reserve assets.

In general terms, international private placement variable life insurance, if issued before December 31, 2015, should be grandfathered from any future CRS reporting. A death benefit only policy (which can be US tax compliant under the IRC 7702 cash value accumulation test) would further buttress this position, as it has no cash value for CRS or FATCA reporting purposes. Meaning that even if the policy was deemed *not* to be grandfathered and was otherwise subject to CRS reporting, there is no value to report.

In addition to the aforementioned, such a policy, if issued from a Puerto Rican based insurer (regardless of its design) would be free from CRS reporting *post* the December 2015 grandfathering date, as Puerto Rico is altogether exempted as a U.S. Territory.

David E. Richardson is CEO of Mid-Ocean Consulting Ltd., in Nassau, Bahamas, which guides both institutions and individuals on sophisticated international structuring and private placement insurance related strategies. Additionally, he sits on the board of a number of private foundations and a wide variety of private companies including several that are SEC registered in the United States. He is a graduate of the ABA sponsored National Trust School at Northwestern University.