VIRTUS TRUST

CRS – a case for wealth-planning using the USA?

Background

The OECD's Common Reporting Standard ('CRS') comes into effect for many countries ('the early adopters') with effect from 1st January 2016. There are about 100 countries who have committed to the programme but we are not aware of any of the bilateral agreements needed to implement CRS, e.g. between Guernsey and Brazil, having yet been drafted, let alone signed and ratified. The attached note (courtesy of lawyers Maitland & Co) illustrates what CRS will involve for clients, trustees, custodians and banks. While logic would suggest that present client financial balances etc. do not need to be reported until bilaterals are in place – and which could take some time - what is in fact happening is that banks are now behaving as though CRS is currently in force and wanting to have their records organized for retrospective reporting.

One example of this is the list of questions now being sent to Virtus in Guernsey regarding opening of new accounts with our principal bankers there:

"Further to this new account being received, I need to ask you a few more questions I am afraid. ***We will also require these answered for all new accounts going forward.***

Purpose of the Account:

1. *What are the main reason(s) for opening an account with Bank X Guernsey Branch: the main purpose of the account and the intended nature of the relationship that you are seeking to establish?*
2. *What type of activity with the account be used for?*
3. *How frequently will the account be utilized? (e.g. daily, weekly, monthly)*
4. *What is the typical value of the transactions that will pass across the account?*

Relationship Rationale for the Account:

5. *Why is an 'offshore' banking relationship required and are tax considerations a factor in this decision?*
6. *Why Guernsey is the jurisdiction of choice?*
7. *Why is Bank X Guernsey Branch your bank of choice?*
8. *Has professional legal/tax advice been sought with respect to any aspect of your offshore account structure? – If YES – please provide a copy/extract of the said advice."*

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It does not take much imagination to see that answering these questions and substantiating the answers will likely be time-consuming, expensive, lead to further questions and potential differences of opinion which could lead to further advisory costs to resolve.

Effect on International Wealth Planning

This line of questioning is likely to be replicated across all the banks and custodians in CRS countries (and that is where 99% of them will be), such that those institutions' compliance departments ('CDs'), many already reeling from regulatory fines, are examining all aspects of structures to which they provide the relevant service. Since trustees in CRS countries will also be under a reporting obligation, it is easy to envisage differences of opinion between trustees and custodians on what is reportable to a third party country. In Switzerland, for example, we have heard of CDs asking for legal opinions from independent counsel on the effectiveness of certain structures with respect to tax deferral and the often associated avoidance of a reporting obligation to the local tax authorities. This would include commonly used structures, but which have never been tested by the local tax courts, such as the 'Unit Trust' for Mexicans and the Bahamas SMART Fund for Brazilians. Many clients have spent a great deal of money on local and international tax advice on these structures but no adviser can say, for sure, that they are 100% effective. That bank CDs are taking this line of questioning is tedious enough but on top of that many clients fear for their personal safety if financial information is remitted to their country in spite of the type of planning and structures mentioned above. STEP is particularly concerned about the security of tax information and possible abuse in many countries with questionable legal or human rights histories (see STEP Journal July 2015). The OECD is aware of the issue but appears reluctant to pass judgment in this regard on any of its members.

Looking for a solution

It can be seen from the above that the private banking and wealth planning world are potentially faced with major upheaval and uncertainty while all the necessary agreements and safety measures are yet to be formally put in place. Clients and their advisers are therefore looking for ways to defer the day when CRS will affect them.

The most notable country not subscribing to CRS is the USA but views differ on how long this can remain the case. Advisers in the US tend to say that the US State system means 'never', while those in authority outside the US like to think the US will have to participate at some stage, although having imposed FATCA this has taken care of its own interests. Many clients are happy to look at the US for the intervening period, even if it's only for a few years, while CRS settles down and in which time hopefully it will be modified or there will be guidance to deal with the above concerns.

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Using the USA to defer the intrusion of CRS

Virtus has already seen a number of enquiries from leading advisers in Europe about using Virtus Trust USA as trustee instead of other jurisdictions subject to CRS (i.e. most) and the concept of the trust under the law of a US State but not being subject to US taxation (foreign grantor trust) is one already being used increasingly as 'offshore' jurisdictions have come under more pressure.

To avoid CRS, which initially will only apply to financial assets, it is not sufficient to have a US trustee but the trust and its underlying entities (BVI cos, NZ LPs etc.) will need to have their liquid assets banked and custodied in the USA too. Virtus has therefore been studying the feasibility of having a US-based master custody account to complement the trustee capability and is close to concluding such an arrangement.

Accompanying this note is another one describing how to set up a trust in the US so that it does not suffer US taxation.

Conclusion and Important Notice

Virtus Trust will only implement and administer structures on which professional advice has been obtained. By setting themselves up to avoid CRS reporting, clients are not absolved from their tax obligations in countries with which they have a nexus and so this note should not be interpreted as aiding or abetting tax evasion. What it is suggesting is that clients' own tax advisers are more likely to know what is reportable in the relevant country than the CDs of banks around the world and that their analysis and danger of erroneous reporting, with potentially dangerous consequences for clients affected, can be deferred for the time being.

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