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The End of the beginning for FATCA and CRS

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The Tax Gap Environment

Governments globally have been clamping down on tax avoidance and evasion for some years by introducing various international tax transparency measures to detect and deter such activity. Additionally, and for the first time, regulators are openly cooperating and indeed collaborating in the battle against financial crime, particularly tax evasion (as they address the 'tax gap' between taxes paid and taxes due).

There have been two principal sources of Regulation for Financial Institutions ("FI's") to consider. The extra-territorial US Foreign Account Tax Compliance Act ("FATCA") and the Common Reporting Standard ("CRS") developed by the OECD. While the intention was to provide a single global framework, national requirements mean that legislation and guidance to implement these initiatives are written uniquely for each country.

We are now in the fourth year of FATCA reporting and the authorities have yet to detail or introduce a formal audit regime. However, governments remain committed to clamping down on tax evasion and high profile data leaks have kept this in both the political and media spotlight. In light of this, it remains unclear how tax authorities will apply the "soft landing" promise made to FI's and indeed whether this will cover more than the first two years originally considered by the IRS.

The FATCA regime requires a formal certification from a Responsible Officer within the FI itself in order to confirm full compliance. The CRS and Directives for Administrative Cooperation regimes do not yet require this step, however tax authorities take comfort from the assurances that are made under the FATCA regime.

HMRC estimates that illegal tax evasion and legal tax avoidance together cost the government about £33 billion a year

The resulting obligations on FIs are significant and are complex due to the different national data requirements and reporting timetables. Each of these new regulations relating to data collection and validation must have been assessed and addressed – whilst simultaneously developing the capability to report relevant information to each of the appropriate regulators.

The Tax AuthorityView



OECD directives have also resulted in a rapidly changing landscape for tax authorities – individual authorities are now subject to peer review by the Global Forum. These reviews will ensure that consistency and robustness applies between every jurisdiction regarding implementation standards.

Tax authorities, in particular HM Revenue & Customs ("HMRC"), have invested heavily in software that will help them identify both individuals and corporate entities that have failed to declare income and assets to the relevant tax authority. Many countries have introduced disclosure facilities – and regulators will now have information from tax payers, which may highlight inadequacies in reporting by the FIs themselves. As projects transition into business as usual, the spotlight is now firmly aimed at the compliance efforts of FIs.

Few organisations have the permanent resources to deal with this onslaught. They may well be forced to mobilise resources within Financial Crime and Compliance functions in addition to Tax. Many organisations will have to bolster these functions by calling on specialist external advice and resources.

In September 2017, under FATCA and CRS, the largest ever exchange of tax information took place between Revenue Authorities globally.

In the UK HMRC is still considering its approach to auditing FIs compliance with FATCA and CRS. However, whilst industry discussions are under way and the OECD has updated the compliance section of the Implementation Handbook, no details of HMRC's approach have yet been published. It is most likely that the tax authority approach will highlight the following:-

- **Data gaps** (such as missing Tax Identification Numbers and incomplete Controlling Persons data)
- **Late filing** – we believe HMRC and other tax authorities have invoked penalties on some FIs for late FATCA/CRS filings
- **Incomplete or inaccurate reporting**
- **Comparison with the returns of industry peers**
- **The Control Environment** – including documentation and process review
- **Walkthrough and sampling of customer data and processes**

The FI View

FIs are continually challenged by a huge and ever-changing regulatory environment, compounded by significant levels of uncertainty in the assessment of compliance by a whole raft of different tax authorities. Penalty regimes are currently under review in many jurisdictions – the underlying theme being dramatically increased severity for non-compliance or inaccurate reporting.

Compliance with these regimes has had two significant impacts. Firstly, there are the financial costs of reviewing/documenting existing procedures, and changing these to meet the various legal obligations. Secondly, these increased requirements can impact on the customer experience – in the form of unexpected requests for new data, which customers may well not be willing to provide.

This increases the difficulty for FIs as they need to accommodate customer concerns and ensure efficient collection of data. FIs clearly need to reduce the impact on the customer and minimize costs. Where possible the collection of data from customers should be automated before processing and reporting in line with the relevant regulations (this can only be achieved within an effective control environment, especially as there is still a degree of fluctuation in the guidance from regulators).

In most cases, the short timeframes between the publication of final legislation and guidance and “go-live”, forced FIs to adopt a tactical solution for the early years of FATCA which may have led to compromises. Any deficiencies may have arisen unwittingly, or perhaps even as a result of the application of an “80/20 rule” in the face of other unavoidable business constraints. Such an approach may have, at that time, been considered an acceptable risk in the knowledge of the “soft landing” promised by IRS and other tax authorities. However with hindsight such compromises or shortcomings may not be considered acceptable now.

WHAT DO FI'S DO NOW?

Whilst tax authorities are gearing up to both audit returns and review underlying compliance, FIs have a short window of opportunity to evaluate the design and implementation of their FATCA and CRS solutions – making changes where required.

FIs need to both identify and consider any compromises or technical gaps that may have been introduced or existed in these tactical solutions and deal with these now – as well as ensuring that these are not replicated in any strategic designs. In many cases such deficiencies may simply have arisen due to lack of IT resource or system constraints, or indeed because the original design did not, or could not, keep pace with developments in Guidance and FAQs. However, that is unlikely to provide sufficient defence against non-compliance at the four-year point and beyond.

In addressing the concerns that tax authorities are likely to consider and any possible mitigation, we recommend that FIs should look at the four key areas below in order to assess their own capability and exposure:

1. Data gaps
2. Late filing, Incomplete or inaccurate reporting
3. The Control Environment
4. Walkthrough and sampling of customer data and processes

The results of this assessment will help inform next steps to ensure that any potential issues are addressed and the risks mitigated where possible. Tax authorities will view errors more favourably if they are identified by the FI rather than themselves and if the FI can demonstrate that steps are being taken to address any issues and gaps.

How EFI can help?

In order to ensure that the approach taken can stand up to scrutiny from the regulators a review should be undertaken to identify weak points and benchmark against peers in the industry. Our team of leading industry FATCA/CRS tax experts can provide support from a review of current risk exposure through to supporting the design and build of operational and technical solutions and controls. We have three core propositions that we can flex to meet individual client's requirements:

1. Review

Walk through of procedures, controls and data to identify any potential gaps or areas for improvement in advance of any such HMRC audit and assess current risk exposure, create plans within a desired time frame and make recommendations to mitigate the risks in line with regulatory requirements

2. Design

Based on the findings of the Review the team can provide a design for the control environment to achieve compliance and reporting whilst detecting any procedural failures as they occur. The design will be created with a plan to deliver the design taking into account budget, time and resource constraints. This is based on the experience of successfully delivering these solutions in a variety of FI's from top tier Banks to small FI's.

3. Build

The final step is to support the development of the control environment, implement the design and automate controls using technological solutions where possible and practical. Again this will follow a plan that reflects the existing requirements and resources to ensure the ongoing reporting is successful and any previous issues are understood and mitigated.

The Authors



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