

STEP Guidance Note: CRS and trusts

John Riches TEP, Chair, STEP Public Policy Committee, 8 March 2017

The purpose of this memorandum is to provide a current summary of issues of concern in the context of how CRS is intended to apply to trusts, persons connected with trusts and trust assets.

This note has been prepared by STEP following discussions with the OECD Secretariat and HMRC and sets out STEP's understanding of the application of the Common Reporting Standard to the circumstances set out below with a view to highlighting points of uncertainty in the reporting framework.

Given that the construction of CRS treaties is a matter of domestic law, it is to be noted that where we reference STEP's understanding of OECD Secretariat's view, that does not mean this represents the only possible construction of the CRS treaty, and the local law must always be considered. It should also not be assumed that OECD or UK HMRC are in full agreement with all of the points set out in this practice note. Although the matters in this note have been discussed with the OECD Secretariat, none of the guidance in this practice note can be seen as endorsed by the OECD.

1. Issues relating to the identity of settlors

We understand the starting point for the analysis under CRS is to identify the settlor of a trust, and this is always relevant whether a Reporting Financial Institution or a passive NFE. In particular, we note from paragraph 69 of the commentary (at page 178) references made to '*any person treated as a settlor of all or a portion of the trust*'. We also note from the handbook at paragraph 217, reference is made to the use of AML/KYC procedures and that, in general terms, Reporting Financial Institutions should rely on such procedures to determine the identity of Controlling Persons '*where those procedures are in accordance with the 2012 FATF recommendations*'.

Various examples were discussed with the OECD Secretariat and HMRC to identify the practical steps that need to be taken in different circumstances to determine the identity of the settlor:

- 1.1 **Example 1: declaration of trust** – in some cases, trustees will declare the terms of a trust in a deed where the settlor is not a named party. In these circumstances, if a settlor is not named as a party to a trust deed, trustees should look to identify the person who has provided the assets that have been contributed to the trust to determine who the 'true' settlor is. When a trust is wholly funded at inception with a contribution from a single individual, there is rarely any doubt about the identity of the individual who should be regarded as the settlor in these circumstances.
- 1.2 **Example 2: trust to trust appointment** – in some cases, trusts are not established directly by a transfer of assets from an individual but by a transfer from an existing trust or similar entity such as a foundation. In these circumstances, applying AML/KYC principles, it would be necessary for a trustee of the receiving trust (Trust 2) to make enquiries of the appointing trust (Trust 1) as to who its economic settlor was when it was created. In the absence of any

'break in continuity' (for instance where the assets pass to an individual and become that individual's personal property), it will normally be safe to assume that the settlor of Trust 1 should also be regarded for CRS purposes as the settlor of Trust 2.

- 1.3 **Example 3: 'nominal' and joint settlors** – there may be trusts in existence where an individual (X) acts as the named settlor of the trust and contributes a nominal amount on its creation but where another individual (Y) then makes the substantive contribution of assets to the trust. In circumstances where trustees satisfy themselves that X has only made a nominal contribution to trust assets and that Y has made the substantive contribution, then applying AML/KYC principles, Y should be regarded as the settlor of the trust for CRS purposes rather than X. However, in accordance with CRS and FATF recommendations, HMRC consider that it is also necessary to identify and disclose X as a settlor and that the full value of the trust assets should be reported with respect to both X and Y notwithstanding the fact that X had added only a nominal amount.
- 1.4 This situation might be contrasted with an alternative scenario where (C) and (D) are joint settlors. For example, it may not be uncommon for a husband and wife to make a transfer of assets to a trust for their children and wider family. If, in these circumstances, C and D contribute assets to the trust from assets that they hold jointly, then it would be fair to regard both parties as 'joint' settlors for CRS purposes. HMRC confirmed that in this case they consider that both C and D would be disclosed as settlors and that the full value of the trust assets should be reported with respect to both C and D, notwithstanding the fact that each had added only a proportion of the trust assets.
- 1.5 **Example 4: settlors who are entities** – we note the guidance set out at paragraph 134 of the Commentary in the context of settlors who are entities. In most cases, the ownership of an entity that acts as a settlor will remain with the same individual. It is however possible that during the lifetime of that individual, ownership of the entity that served as the settlor could change. In these circumstances, it is necessary to consider the Controlling Person of the entity *at the time it contributes assets to the trust* in order to determine who should be regarded as the settlor for CRS purposes. HMRC are of the view that it is also necessary to identify the Controlling Persons of the entity during each relevant year with respect to which the report is made. This is viewed as important on the basis that the entity may still have some continuing role with respect to the trust, e.g. powers of the trust assets or a power of revocation. In this case, however, the Controlling Persons with respect to the entity could be disclosed within the category of 'any other natural person exercising effective ultimate control'.
- 1.6 In circumstances where an entity is jointly owned by two or more persons it is necessary to identify all of the relevant Controlling Persons as settlors or as 'any other natural person exercising effective ultimate control' for CRS purposes.
- 1.7 **Example 5: dead settlors** – there is no express guidance on the position where a person regarded as the settlor of a trust for CRS is deceased. We understand if

one considers both paragraph 222 and table 7 in the Implementation Handbook and one of the responses to the FAQs issued in June 2016 (at page 2 on reporting requirements in year of closure of a trust account), that one should reference the '*fact of closure*'. We consider it is correct to say by analogy that in the year in which a settlor dies, his equity interest in relation to the trust will be regarded as having 'closed'. Logically, in subsequent years, a dead settlor will have no equity interest that is capable of being reported and equally cannot be a Controlling Person of a trust. This position is understood to be accepted by HMRC.

- 1.8 **Example 6: settlors who cannot be beneficiaries of trust.** There are many cases in which settlors will have established trusts from which they are formally and completely excluded as beneficiaries at inception (or subsequently). HMRC are of the view that in these circumstances the settlor's equity interest (if the trust is a Reporting Financial Institution) should be reported as the full value of the trust assets and cannot be regarded as having a zero value. STEP has pointed out it will be helpful in future to be able to add information that the individual has been permanently excluded in order to avoid unnecessary enquiries by the settlor's home tax authority.
- 1.9 **Example 7: settlors following absolute appointments.** There will be circumstances where trust assets are appointed from an existing trust (Trust 1) settled by A outright to B. B then, in due course, transfers some of those assets to a new trust, Trust 2. In this scenario, B should be regarded as the settlor of Trust 2 under AML/KYC principles because he has become the outright owner of assets that have then subsequently been contributed to a new trust arrangement. In these circumstances, only B should be reported as the settlor for CRS purposes.

2. Issues relating to the question of what constitutes a trust as a reporting entity for CRS purposes

A separate topic that has not been addressed in any OECD guidance is the issue of when one determines what trust arrangements are part of a 'single composite' trust rather than segregated individual trusts that need to be reported on a standalone basis. The key point to note here is that, over time, trust arrangements can evolve and become more complex.

- 2.1 **Example 8:** A establishes a trust for the benefit of A's three children X, Y and Z on discretionary trust. The trust is irrevocable and A is excluded from benefit. At the time of creation of the trust, X, Y and Z are teenage children and the trust is administered for them in undivided shares. Some years later, X, Y and Z are now adults and the trustees take a decision to appoint specific assets to separate sub-funds (i) one for the benefit of X and his children; (ii) one for the benefit of Y and his children; (iii) one for the benefit of Z and his children; and (iv) the remaining fund being held for the benefit of all of X, Y and Z and their children. In these circumstances, for CRS purposes there could be one composite trust or there

could be four, depending on the facts and circumstances as to how the trusts are administered.

- (a) If the trustee (or trustees) administers the sub-funds as one trust, any CRS reporting should be on the basis that it is one composite trust, notwithstanding the fact that separate sub-funds have been set up.
- (b) If the trustee (or trustees) administers some or all of the sub-funds as separate trusts, any CRS reporting should be on the basis that those sub-funds are separate trusts.

2.2 Trustees could be regarded as treating the sub-funds as separate trusts where, for example (and this is not an exhaustive list), a replacement or additional trustee is appointed in relation one sub-fund but not all; different protectors are appointed in relation to each sub-fund; there is no cross-over of beneficiaries in each sub-fund; the trustees treat the sub-funds as separate trusts for tax purposes. HMRC's position is that the identification of sub-funds as one trust or separate trusts should follow the facts in each case and should be reported as separate trusts only where the facts demonstrate that separate trusts have been created.

3. Issues relating to beneficiaries

3.1 The Standard (page 51 – C(4)) defines the term 'Equity Interest' in relation to a trust that is an FI as follows: 'In the case of a trust that is a Financial Institution, an equity interest is considered to be held by any person treated as a settlor or beneficiary of all or a portion of the trust, or any other natural person exercising ultimate effective control over the trust. A Reportable Person will be treated as being a beneficiary of a trust if such Reportable Person has the right to receive directly or indirectly (for example, through a nominee) a mandatory distribution or may receive, directly or indirectly, a discretionary distribution from the trust.'

In the Commentary (page 178 paragraph 70) it states that: 'For these purposes, a beneficiary who may receive a discretionary distribution from the trust only will be treated as a beneficiary of a trust if such person receives a distribution in the calendar year or other appropriate reporting period (i.e. either the distribution has been paid or made payable).' Note that this limitation is contained in the Commentary and not the Standard itself, which has a wider definition of beneficiary. Although jurisdictions implementing the Standard are encouraged to follow the Commentary when applying and interpreting the relevant domestic law provisions, jurisdictions may not do so, so the local law must always be considered.

3.2 In relation to a trust that is an NFE, it is necessary to identify Controlling Persons. Controlling Persons are defined in the Standard (page 57) in relation to a trust as follows: 'In the case of a trust, such term means the settlor(s), the trustee(s), the protector(s) (if any), the beneficiary(ies) or class(es) of beneficiaries, and any other natural person(s) exercising ultimate effective control over the trust'.

The Commentary (pages 198 and 199, paragraph 134) states: ‘The settlor(s), the trustee(s), the protector(s) (if any), the beneficiary(ies) or class(es) of beneficiaries must always be treated as Controlling Persons of a trust, regardless of whether or not any of the exercises control over the trust... For beneficiary(ies) of trusts that are designated by characteristics or by class, Reporting Financial Institutions should obtain sufficient information concerning the beneficiary(ies) to satisfy the Reporting Financial Institution that it will be able to establish the identity of the beneficiary(ies) at the time of the pay-out or when the beneficiary(ies) intends to exercise vested rights. Therefore that occasion will constitute a change in circumstances and will trigger the relevant procedures. When implementing the Common Reporting Standard, a jurisdiction may allow Reporting Financial Institutions to align the scope of the beneficiary(ies) of a trust treated as Controlling Person(s) of the trust with the scope of the beneficiary(ies) of a trust treated as Reportable Persons of a trust that is a Financial Institution (see paragraphs 69-70 above)’.

- 3.3 There is clear commentary at paragraphs 202 and 203 of the Implementation Handbook that makes a distinction between beneficiaries entitled to 'mandatory' distributions and those who are discretionary without any enforceable rights to receive trust property.

4. Discretionary beneficiaries

4.1 Excluding discretionary beneficiaries from a trust

The answer to FAQ 6 in Section 1 of the June 2016 publication addresses the question of intermittent distributions to discretionary beneficiaries of a trust that is an RFI. It notes in particular that if discretionary beneficiary receives a distribution in a particular year but not in subsequent years, the absence of a distribution should not be treated in effect as an account closure '*as long as the beneficiary is not permanently excluded from receiving future distributions from the trust*'.

There is no need to report the death of a discretionary beneficiary as an 'account closed' matter as distinct from circumstances in which the beneficiary is formally excluded as a beneficiary during lifetime.

Further, in circumstances where a trust is wound up because all of the assets are appointed for the benefit of one of the discretionary beneficiaries, it is not then expected that all beneficiaries who have previously received distributions in prior years (who can no longer benefit from the trust assets) would be referenced in the year of the distribution of the trust fund to another beneficiary.

4.2 Identifying the class of discretionary beneficiaries for the purposes of reporting

There are a number of cases where it is necessary under CRS to identify discretionary beneficiaries who may not have received a distribution in a particular accounting year. This is specifically the case in circumstances where the trust is a passive NFE where the relevant jurisdiction has not permitted the

option of allowing FIs to identify discretionary beneficiaries as Controlling Persons only when they receive a distribution. In order to make the reporting of discretionary beneficiaries sensible and manageable, it would seem sensible that a discretionary beneficiary should only be treated as a Controlling Person *where the discretionary beneficiary concerned is eligible to receive a distribution in the year concerned*. We set out below some common scenarios below. In many cases these contingent or default beneficiaries may be totally unaware of the fact that they are named as beneficiaries in such a trust.

HMRC's view is that where a trust is a passive NFE, it is a requirement of the EU Directive that all beneficiaries be identified as Controlling Persons, including named discretionary beneficiaries, regardless of any contingencies under which they might receive a benefit. In STEP's view, consideration should be given to the specific terms of the trust to determine whether any named individual can be regarded as a beneficiary of the trust in the relevant year.

- (a) **Example 9:** Beneficiaries include individuals X and Y and their children and remoter issue. The children and remoter issue are identified by reference to a class and not named individually and no distributions are made to them during the year. In this case it is only necessary to identify X and Y. Current, contingent or default beneficiaries who are only described by reference to a class and are not named and have not received distributions do not need to be identified as Controlling Persons.

5. Beneficiaries receiving mandatory distributions

- 5.1 This category of beneficiary may, if the income interest has been provided for the duration of their lifetime, be known as having a 'life interest' or 'fixed interest' in the trust income. It will be necessary to consider carefully the terms of the trust instrument to form a judgement as to whether an unqualified right to receive trust income does exist as opposed to one that is dependent upon the exercise of a trustee's discretion.
- 5.2 The Implementation Handbook makes reference to values being reported by a Reporting Financial Institution in the context of mandatory beneficiaries.
- 5.3 The Implementation Handbook states (at paragraph 220) in relation to trusts that are RFIs: 'The account balance is the value calculated by the Reporting Financial Institution (the trust) for the purpose that requires the most frequent determination of value. For...mandatory beneficiaries, for example, this may be the value that is used for reporting to the Account Holder on the investment results for a given period. If the Financial Institution has not otherwise recalculated the balance or value for other reasons, the account balance for...mandatory beneficiaries may be the value of the interest upon acquisition or the total value of all trust property'.
- 5.4 For trusts that are passive NFEs, the Implementation Handbook states (at paragraph 236) that 'The financial information to be reported will be the account balance or value of the account held by the trust and payments made or credited

to such account. Each Controlling Person is attributed the entire value of the account, as well as the entire amounts paid or credited to the account, as shown below in Table 8.'

5.5 It is understood that if there is a class of one or more beneficiaries who are:

- (a) entitled to part of the income of a common trust fund; or
- (b) entitled to all the income of a separate sub-fund

then any reporting that needs to be made by reference to the mandatory beneficiary should be based on the relevant sub-fund or proportion of common fund that the beneficiary has an income interest in. HMRC's position is that the identification of sub-funds as one trust or separate trusts should follow the facts in each case and should be reported as separate sub-funds only where the facts demonstrate that separate sub-funds have been created.

5.6 **Example 9:** Beneficiary A has a right to receive all the income from Trust A. In this case A is reported as having a mandatory interest in the whole of Trust A.

5.7 **Example 10:** Beneficiary A has a right to receive X% of the income from the trust and B has the right to receive Y% of the income from the trust and the trustee reports to them on this basis.

- (a) If the trust is an RFI, A is reported as having a mandatory interest in X% of the value of the trust assets and B is reported as having a mandatory interest in Y% of the value of the trust assets.
- (b) If the trust is a passive NFE, the full value of the trust assets are reported with respect to both A and B.

5.8 **Example 11:** A is treated as the grantor of Trust X for US tax purposes. A has a power of revocation (or equivalent) over the assets of Trust X. The income of Trust X is payable to, or on the order or direction of, A. A may direct the trustees to distribute the income to him or to other persons. No distributions are made to A or any other person. In this case, A is not reported as having a mandatory interest in the assets of Trust X as there is no mandatory obligation to distribute income to him (although he will be reported as the settlor and may be reportable as a person who has the power to exercise effective control over the trust).

6. Issues relating to protectors

6.1 Paragraph 204 of the Implementation Handbook states '*a protector may also be appointed in connection with a trust. This is not a compulsory requirement of a trust but may be included in some jurisdictions. A protector enforces and monitors the trustees' actions such as overseeing investment decisions or authorising a payment to a beneficiary*'.

6.2 This is necessarily a very brief summary of the potential roles that a protector may play. Some protectors are given very extensive powers and have an active

role in monitoring the activities of trustees, while others have a very passive role and are only called upon to intervene in emergency situations. Sometimes, protectors are given a power to appoint or remove trustees as well. In many cases a protector would not be regarded as a person 'exercising ultimate effective control' over a trust.

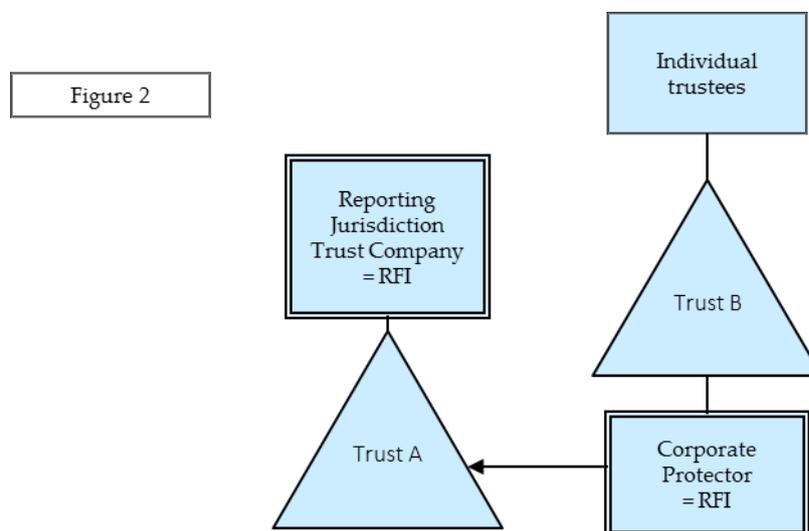
- 6.3 In the drafting of the CRS framework surrounding trusts, protectors are dealt with very differently if one compares the situation of a trustee who acts as an RFI compared with a situation where the trustee is a passive NFE.
- 6.4 In the former case, the CRS framework provides for reporting in the context of trustees who are RFIs to be made of persons who are treated as having an 'equity interest' in the trust fund. In this context, Section VIII.C.4 of the Standard states that an equity interest is held *'by any person treated as a settlor or a beneficiary of all or a portion of the trust or any other natural person exercising ultimate effective control over the trust'*.
- 6.5 By contrast, in relation to a trust that is a passive NFE, it is necessary to identify Controlling Persons in relation to the trust. In the Standard, Section VIII D(6) defines 'Controlling Person' on the basis that the expression is intended to correspond to the term 'beneficial owner' as described in Recommendation 10 and the interpretative note on Recommendation 10 of the FATF guidance as adopted in February 2012. In the case of a trust, Controlling Persons means *'settlor, the trustees, **the protector (if any)**¹ the beneficiary or class of beneficiaries and any other natural person exercising ultimate effective control over the trust'*.
- 6.6 We note that in its FAQ issued in June 2016, OECD takes the position that where a trust is a Reporting Financial Institution, a protector *'must be treated as an account holder irrespective of whether it has effective control over the trust'*. This response does not address the clear distinction in the Standard itself between the holders of equity interests in a trust that is an RFI (see paragraph 6.4 above – which only includes protectors if they actually exercise ultimate effective control), when contrasted with the Controlling Persons definition of a trust that is a passive NFE (see paragraph 6.5 above which includes protectors regardless of the powers they hold). In this context, we note that the OECD's guidance does not constitute a legally binding interpretation of the Standard and that the RFIs should seek their own legal counsel before determining their formal reporting position, given that the legal basis for the position taken by OECD is unclear to us. We note that the OECD Secretariat has confirmed that it is the intention that protectors of trusts that are RFIs should be reported and the FAQ was discussed and approved in the relevant Working Party of the OECD. Until the legal basis for this is made clear in the CRS treaty, it is considered that there is a reasonable basis for forming the opposite conclusion.

¹ Emphasis added

7. Issues relating to Controlling Persons that are entities

Paragraphs 214 and 230 of the Implementation Handbook confirm it is necessary to look through any entity that is a settlor, trustee, protector, etc to identify those holding an equity interest or being regarded as a Controlling Person of the trust.

- 7.1 **Example 12:** Trust A has a corporate trustee (RFI) and a corporate protector (RFI). Under the guidance it appears to be necessary to identify the Controlling Persons in relation to both the trustee and the protector, regardless of whether the trust is an RFI or a Passive NFE. In the example below (Figure 2), the corporate protector of Trust A is a professional protector administered by a law firm in a jurisdiction that has implemented the CRS. The corporate protector is owned by Trust B for the benefit of the partners of the law firm. The trustees of Trust B are the individual partners of the law firm. The Implementation Handbook suggests that it would be necessary to treat the individual trustees of Trust B as Controlling Persons of Trust A and disclose the full value of Trust A's assets in relation to such persons, even though they have no interest in nor any control over such assets. The OECD are considering the extent to which it is necessary to identify Controlling Persons in a chain of entities. One way to mitigate the burden in this situation would be to provide guidance that it is not necessary to look through an RFI in these circumstances (assuming that, in this case, the corporate protector is an RFI because it conducts one of the enumerated activities as a business on behalf of customers). If that guidance were provided, the due diligence and reporting obligations would fall on (and only on) the RFI that is closest to the individuals to be reported.



- 7.2 **Example 13:** There are also a number of professional trust and protector companies where a controlling interest is held by an independent private equity fund. For example, an interest in a global fiduciary service provider corporate and fund services group has been acquired by a private equity house. The acquired company is a multi-jurisdictional business that provides trust and corporate services to a wide range of clients across the globe, administering over 10,000 structures for almost 6,000 clients from nine locations. The business has three

core service lines: Corporate Administration, Trust Administration and Fund Services. This investment was made by a buyout fund. If you follow the above analysis, it would be necessary to identify and provide information about the Controlling Persons of the private equity fund as ultimate owners of the trust company, which include the investors in the buyout fund and private equity fund personnel. None of these people have any connection with the underlying trusts managed by the trust company that holds the relevant financial account. As the trust company, in this case, is an RFI (which is likely to be the case, save in relation to US service providers) and it was not necessary to look through the RFI, this information would not need to be disclosed.

- 7.3 We suggest that the solution to this issue is to conclude that in circumstances where a Controlling Person in relation to a trust is itself a regulated service provider that offers professional trustee services, as a practical matter there should be no need to identify the natural persons who own that regulated service provider but only the directors (or similar) who control that regulated service provider. We understand that the OECD is still considering the reporting of Controlling Persons in an ownership chain of entities.

8. Charitable trusts

A charity that is an NFE may be treated as an active NFE if it meets certain requirements. However, many charities fall within the definition of FIs because they hold endowment funds that are professionally managed. It appears that under the CRS, these charities would be treated as RFIs. FATCA treats such charities as non-reporting. In HMRC's view, there are sound policy reasons for treating certain charities as RFIs. For further guidance on this point, see HMRC's charity guidance at <https://www.gov.uk/guidance/automatic-exchange-of-information-guidance-for-charities>

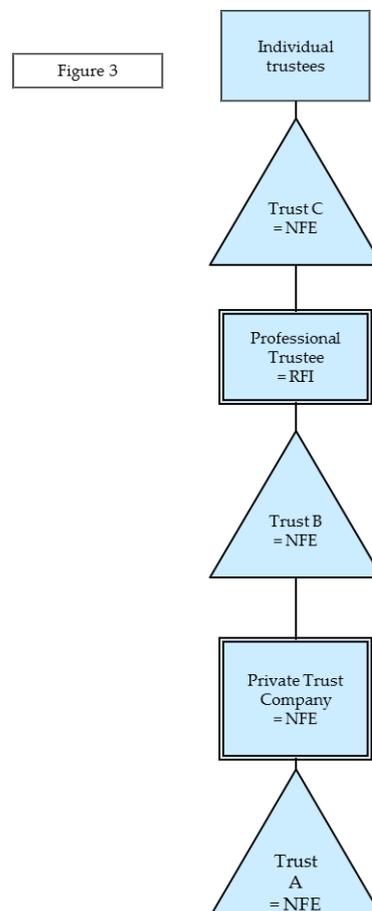
9. Private trust companies (PTCs)

- 9.1 The only existing commentary that exists in OECD materials with regard to private trust companies is in the Implementation Handbook on page 113. This comments on the role of a private trust company in the context of a 'managed by' test for the purposes of when an entity will be managed by another entity. This ignores the fact that many families use PTCs to act as trustee of trusts in a manner where the PTC conducts activity in its trustee capacity that is synonymous with that undertaken by professional trustee companies, i.e. the PTC would oversee in its trustee capacity the investment activity being undertaken by the trust, which would be regarded as an investment entity for this purpose.
- 9.2 It should be noted that, typically, the administration of the PTC will be required to be carried on by a trust and corporate service provider (TCSP) who is generally a person regulated in that capacity in many jurisdictions. Many of the offshore jurisdictions in their guidance on US FATCA make it clear that PTCs could, on the basis set out above, elect to be treated as FIs if, in similar circumstances, a professional trust company would be an FI.

- 9.3 There are many ownership structures associated with a PTC. A typical holding structure is where the shares in the PTC are owned by a purpose trust, the trustee of which is an independent professional trustee. In this case, the professional trustee has the power to change the directors of the PTC but otherwise has no control, influence over or interest in the trusts of which the PTC acts as trustee.
- 9.4 **Example 21:** A private trust company acts as trustee of Trust A. The directors of the PTC are Z, X and Y and they alone exercise control over PTC. The shares in the PTC are owned by Professional Trustee as trustee of Purpose Trust B. Professional Trustee is one of the services provided by a law firm in offshore jurisdiction. Professional Trustee is owned by Trust C for the benefit of the partners of that law firm. The partners of the law firm are trustees of Trust C.

If you follow through the guidance, it would be necessary to identify as Controlling Persons of Trust A, Trust B, Professional Trustee, Trust C and Individual Trustees. None of these persons exercises control over Trust A or has any financial interest in Trust A.

Conclusion: In this scenario it would be helpful to have guidance that only individuals or entities who actually exercise effective control over PTC should be identified – in this case the directors of PTC X, Y and Z but not the shareholders. It should be noted that the OECD is still considering the reporting of Controlling Persons in an ownership chain of entities.



10. 'Managed by' test

10.1 In the Standard, the term 'Investment Entity' means any entity:

- (a) that primarily conducts as a business one or more of the following activities or operations for or on behalf of a customer:
 - (i) trading in money market instruments (cheques, bills, certificates of deposit, derivatives, etc.); foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures trading;
 - (ii) individual and collective portfolio management; or
 - (iii) otherwise investing, administering, or managing Financial Assets or money on behalf of other persons; or
- (b) the gross income of which is primarily attributable to investing, reinvesting, or trading in Financial Assets, if the entity is managed by another entity that is a Depository Institution, a Custodial Institution, a Specified Insurance Company, or an Investment Entity described in subparagraph A(6)(a).
- (c) An entity is treated as primarily conducting as a business one or more of the activities described in subparagraph A(6)(a), or an entity's gross income is primarily attributable to investing, reinvesting, or trading in financial assets for purposes of subparagraph A(6)(b), if the entity's gross income attributable to the relevant activities equals or exceeds 50% of the entity's gross income during the shorter of: (i) the three-year period ending on 31 December of the year preceding the year in which the determination is made; or (ii) the period during which the entity has been in existence. The term 'Investment Entity' does not include an entity that is an active NFE because it meets any of the criteria in subparagraphs D(9)(d) through (g).

This paragraph shall be interpreted in a manner consistent with similar language set forth in the definition of 'financial institution' in the Financial Action Task Force Recommendations.

10.2 Paragraph 17 of the Commentary to Section VIII states 'Subparagraph A(6)(b) defines the second type of 'Investment Entity' as any Entity the gross income of which is primarily attributable to investing, reinvesting, or trading in Financial Assets, if the Entity is managed by another Entity that is a Depository Institution, a Custodial Institution, a Specified Insurance Company, or an Investment Entity described in subparagraph A(6)(a). An Entity is 'managed by' another Entity if the managing Entity performs, either directly or through another service provider, any of the activities or operations described in subparagraph A(6)(a) on behalf of the managed Entity. However, an Entity does not manage another Entity if it does not have discretionary authority to manage the Entity's assets (in whole or part). Where an Entity is managed by a mix of Financial Institutions, NFEs or individuals, the Entity is considered to be managed by another Entity that is a Depository Institution, a Custodial Institution, a Specified Insurance Company, or an Investment Entity described in subparagraph A(6)(a), if any of the managing Entities is such another Entity.'

In a typical trust example, the PTC or the holding company (owned by the trust) enters into a contract with a corporate service provider to provide services that

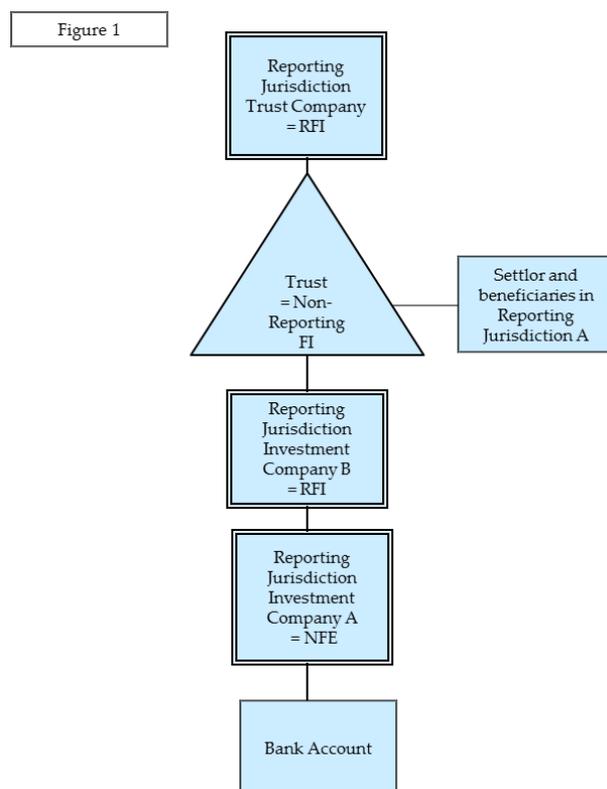
include ‘investing, administering, or managing Financial Assets or money’ on behalf of the trust or underlying holding company. As part of the services provided, the corporate service provider will provide a director (either and individual or corporate director) who will be directly responsible (with the other directors) for the investment of the underlying assets of the trust or holding company.

The corporate service provider will charge a fee for such services. The corporate service provider will, in many circumstances, provide services to other third parties. On occasion, the corporate service provider may provide such services only to the trust, holding company and other related entities.

- 10.3 The guidance in some IGA jurisdictions in relation to US FATCA confirmed that a trust can be treated as an FI if it receives services from a Trust and Corporate Service Provider (TCSP) that is itself an FI.
- 10.4 The guidance also considers the provision of directors to a company. While noting that the provision of individual employees or partners of a company services provider to serve as directors of an entity will not usually (on its own) cause the company to fall within the ‘managed by’ test, the guidance notes that a company with individual or corporate directors provided by a corporate services provider may, should it wish to do so, elect to be treated as being managed by such corporate service provider and so be an investment entity itself.

HMRC take the view that the provision of individual employees or partners of a company services provider (or similar) to serve as directors of an entity in the circumstances outlined above will cause the company to fall within the ‘managed by’ test.

11. Looking through a passive NFE owned by a trust



- 11.1 In the above example, the Bank will obtain AML information about Company A. Company A is an NFE in a jurisdiction that has implemented the CRS. Company A is owned by Company B. Company B is an RFI in a jurisdiction that has implemented the CRS. Company B is owned by a trust of which a corporate RFI is trustee.
- (a) The Bank will want to identify Controlling Persons for Company A. Under current guidance, it is unclear who the Controlling Persons of Company A are.
 - (b) As a threshold matter, because Company A is owned by a Reporting FI in a Participating Jurisdiction, it is not entirely clear whether Company A should (as a policy matter) be required to identify its Controlling Persons, because Company B and the trust will have to identify their Account Holders and report them, if they are reportable.
 - (c) Assuming that Company A is required to identify its Controlling Persons, it is unclear whether any individual would hold a controlling interest by ownership. Arguably, each Controlling Person of the trust may be treated as a Controlling Person of Company A. Alternatively, the senior managing official of Company A might be seen as the Controlling Person.
- 11.2 Company B will need to identify its Account Holders. In this example, its Account Holder is the trust, which is not a Reportable Person because it is an RFI. Company B therefore has nothing to report.
- 11.3 The trustee will identify the Account Holders of the trust. This will include in the example in Figure 1: the settlor, any mandatory beneficiaries, and any discretionary beneficiaries who have received distributions. The trustee will report the full value of the trust assets in relation to the settlor and any mandatory beneficiaries, and the amounts distributed to any mandatory and discretionary beneficiaries.
- 11.4 Note: As pointed out above, there is no advantage in the Bank having to look through Company A, Company B, and the trust to the Controlling Persons of the trust. If the Bank is required to look through the trust, the Bank would disclose the value of the account by reference to the settlor and all of the beneficiaries, whether or not they have received a distribution. It should be noted that, under the US FATCA regulations, it is not necessary to look through Financial Institutions (such as the trust in this example). We understand that the OECD is still considering further guidance on the reporting of Controlling Persons in an ownership chain of entities.

12. Meaning of 'distribution'

12.1 There is guidance in the context of the UK IGAs (in the Jersey notes) that states that a payment to a beneficiary by way of loan is not a distribution in the year the loan is made, but only when it is written off. See page 58 in the attached guidance:

<http://www.gov.je/TaxesMoney/InternationalTaxAgreements/IGAs/Pages/UKIGA.aspx#anchor-0>

12.2 A loan that is on commercial terms (i.e. a loan that is not on beneficial terms) should not be treated as a distribution.

12.3 HMRC have been asked to consider whether an interest-free loan or a loan made on other than commercial terms (e.g. in circumstances where a beneficiary, if UK resident, would be treated as receiving a capital benefit from the trust for the purposes of section 87 TCGA 1992) would be disclosable as a distribution in the year it is made or the year it is written off (but not the years when the loan remains outstanding).

13. Account closed issue

13.1 Table 7 in the Handbook implies that if the equity interest comes to an end in a CRS Reporting Year, no information needs to be given by the trustee about the prior payments to a beneficiary. This could arise because

- (a) a beneficiary is excluded (see FAQs on discretionary beneficiary);
- (b) a settlor dies;
- (c) a protector resigns (if the protector is reportable);
- (d) a trustee retires; or
- (e) the trust is wound up completely.

13.2 In this event, HMRC confirmed that they consider it is necessary also to report all other relevant activity during the calendar year.

14. Trust to trust transfers

14.1 Normally a transfer from one trust to another is not reportable because there is no distribution to a beneficiary of the trust where the trustee is exercising an express power or overriding power of appointment to make a trust to trust transfer.

14.2 The same considerations should apply where the recipient trust is a charitable trust.

14.3 However, HMRC note that a distribution to an entity recipient will result in the recipient entity being regarded as a beneficiary of the trust, so due diligence

should be carried out by an RFI to identify whether the entity is a reportable person.

- 14.4 Whether a recipient is an entity or a natural person will be relevant where the recipient is a beneficiary of a trust that is a passive NFE and the RFI is identifying Controlling Persons. The entity is still identified and due diligence carried out on the entity, but additionally the RFI must establish and carry out due diligence on the Controlling Persons of that entity. The only difference would come where the beneficiary is a charity, because the charity would usually be an active NFE, where not an RFI in its own right.