

Rules of Engagement - Cayman on the Front Foot



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A DAPTING TO NEW REGULATION SUCCESSFULLY IS A CRITICAL ELEMENT for survival in international finance. The Cayman Islands have adopted a high-engagement approach when it comes to international initiatives, seeking to be the first offshore jurisdiction to practically and sensibly accommodate global tax and regulatory additions. Cayman's history of cooperation is long, including tax assistance initiatives with the USA and implementing measures of the European Union Savings Directive.

As standards in Exchange of Tax Information have evolved over the last few years from an exchange on-request between countries towards automatic exchange, Cayman has been an early adopter of these standards. Its commitment is demonstrated by its participation in the G5 pilot for automatic exchange of information in April 2013 and its early engagement with the USA and UK in negotiating intergovernmental agreements (IGAs) for FATCA and the UK measures to improve international tax compliance. In November 2013, the Cayman Islands signed IGAs with the UK and the USA, and enacted legislation and regulations which came into force in July 2014.

FATCA Goes Global

As the financial services industry continues to adjust to operating under FATCA and the equivalent UK measures (which are often referred to as UK FATCA), the OECD recently announced

further progress in the global exchange of information between tax authorities. All OECD and G20 countries as well as several major financial centres participating in the Global Forum on Transparency and Exchange of Information for Tax Purposes endorsed the Standard for Automatic Exchange of Financial Account Information (also referred to as the Common Reporting Standard or CRS). As of November 2014, 51 jurisdictions, including the Cayman Islands, have signed a multilateral competent authority agreement (the MCAA) under which they have committed to commence reporting by September 2017. These jurisdictions are required to have enacted legislation and regulations by June 2015 in order for data collection to begin in 2016.

CRS - More of the Same?

Although the CRS has been referred to as 'Global FATCA', it is important to recognise that there are subtle but significant differences which greatly increase the complexity of financial institutions' obligations compared with USA and UK FATCA.

Naturally, the global scale of the CRS is the most complicating factor with the possibility that the competent authority agreements (CAAs) to implement the CRS may differ slightly between each jurisdiction. This is already an issue for financial institutions when seeking to comply with USA FATCA in various jurisdictions. Although there are only two models of IGA (Model 1 direct or

Model 2 indirect reporting) for USA FATCA, there is scope for the contracting authorities to modify the terms of their IGA. Accordingly, financial institutions with a presence in multiple jurisdictions cannot adopt a one size fits all approach to information gathering.

While USA FATCA refers to citizenship, the CRS is based upon tax residence. Such residence will depend on the tax laws of the jurisdiction of residence and an account holder may be deemed to be a resident of multiple jurisdictions for tax purposes. This will cause difficulties for financial institutions seeking to validate disclosures made by the account holder during self-certification.

Under FATCA, a de minimis exclusion for accounts with lower values relieves many institutions from reviewing the vast majority of their accounts (and may even mean that the institution is not a financial institution for FATCA purposes). The CRS will not have such an exclusion. This means all accounts must be reviewed and many more may be reportable under the CRS. The scale of such obligations will make manual or semi-manual procedures impractical.

Under USA FATCA there are requirements to withhold payments to recalcitrant investors or non-participating financial institutions. Financial institutions must also register for a Global Intermediary Identification Number (GIIN). Under UK FATCA, there is no withholding or central registration requirement with HMRC. The CRS



follows UK FATCA in this regard. However, governments in implementing countries may require financial institutions to register locally in order to monitor compliance.

What's Cayman doing about all this?

The Cayman government continues to work closely with the US Treasury to resolve uncertainty in the implementation of FATCA. For example, the Cayman Islands Tax Information Authority (the TIA) recently received and distributed confirmation of the requirements for self-certification. The TIA was among the first to release guidance notes in relation to its IGAs in July 2014 and as at November 2014, is the jurisdiction with the highest number of GIIN-registered financial institutions.

A second iteration of the TIA's guidance notes is expected in December 2014 and the TIA is in the process of developing its online systems for FATCA notification and reporting in Cayman. It is anticipated that the reporting format will be finalised and published in early 2015 at which time the TIA website will open for financial institutions to notify and report to TIA. Financial institutions will need to notify the TIA of their status as reporting financial institutions by 31 March 2015, or 31 March of the year in which it becomes a reporting financial institution. The reporting format will be consistent with schemes currently published by the IRS for USA FATCA and by the OECD for the CRS. Under the Tax Information Authority (International Tax Compliance) Regulations for UK and USA FATCA, reporting of the prescribed information will need to be completed by 31 May 2015.

As the FATCA reporting system is finalised, the Cayman government will now turn its focus to the early adoption of the CRS, which requires regulations to be made in 2015, for the legislative framework to be in place for financial institutions to collect the required data in 2016 and reporting to commence in 2017.

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One of the key considerations highlighted in the implementation of the CRS will be ensuring that data protection is satisfactory to each of the parties. Prior to a CAA for the implementation of the CRS becoming effective, the competent authorities must each submit details of its methods for data transmission (including encryption), safeguards, if any, for the protection of personal data, and confirmation that it has in place adequate measures to ensure the required confidentiality and data safeguards standards are met.

What's Next?

While FATCA remains the immediate priority, financial institutions should be taking a similarly proactive approach to developing their internal systems and measures for gathering tax residence information from all investors and preparing for the reporting and monitoring phase. Although the due diligence processes which have been implemented for FATCA may provide some foundation for compliance with the CRS, they must be flexible enough to account for the many variations which may arise from the global nature of the CRS. Most significantly, differences in the classification of entities will require further due diligence which may not currently be required under FATCA.

Given that implementation of the CRS is likely to be complex, we recommend that financial institutions closely monitor regulatory developments. Currently, financial institutions are being advised to commence preparations for collection of data from their investors en masse,

rather than selectively collecting data and reviewing procedures as and when relevant CAAs are entered with partner jurisdictions. The viability of such an approach will of course depend on the demographics of the financial institution's account holders.

It will no longer be practical to avoid the cost of compliance by closing the accounts of or denying access to reportable account holders. The seemingly inevitable spread of the CRS will require disclosure to a much larger number of partner jurisdictions and refusing investors from all such jurisdictions would deny financial institutions access to valuable capital. For financial institutions which have chosen to disregard FATCA to date (potentially due to a negligible number of reportable account holders or losses from any withheld payments), the onset of the CRS and the trend towards global transparency that it represents cannot be ignored. Cayman is pro-actively seeking to provide for cost-effective regulation to minimize the burden of this. ■

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