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Introduction of the Crypto-Asset Reporting Framework and the proposed amendments to the Common Reporting Standard

Summary

The OECD published the Crypto-Asset Reporting Framework (CARF) and the proposed amendments to the Common Reporting Standard (CRS) on 10 October 2022 and was presented to the G20, where it was reviewed by the Finance Ministers and Central Bank Governors.

The OECD release sets out a new tax transparency framework for the reporting and automatic exchange of information in respect of crypto-assets and expand the scope of the CRS to cover digital assets to align with the current market developments and further improve the operation of the CRS.

Groups will need to ascertain which entities and transactions are in scope, what additional information is needed from users, and whether current IT systems are adequate to collate and report the required information.

Unlike the traditional financial assets and currencies, crypto-assets (including crypto-currencies, utility tokens, non-fungible tokens) can be transferred and held without interacting with traditional financial intermediaries. Further, central administrators as well as local regulators currently do not have full visibility on how and where these crypto-assets transactions are carried out.

Following earlier consultations relating to reporting on crypto transactions, the OECD released a publication entitled “Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard” on 10 October 2022, which contains the rules and commentary of the CARF and the proposed amendments to the CRS as approved by the OECD in August this year.

A high-level summary of the CARF and proposed amendments to the CRS are provided below.

Overview of the CARF

The current CRS framework for international tax transparency on cross-border financial investments and offshore assets held with financial institutions focuses on traditional financial assets and currencies. Crypto-assets in most of the cases do not fall within the scope of the current CRS framework. Where crypto-assets may fall within the definition of financial assets under the CRS, these assets remain outside the reporting framework and largely go unreported given they are owned by individuals through cold-wallets or via crypto-asset exchanges that do not have the CRS reporting obligations (as they are not financial institutions).

To bridge this gap, the OECD introduced the CARF for the disclosure and exchange of information in respect of crypto-assets transactions. The information to be collected under the CARF is generally similar to the information collected under the current CRS framework in many aspects, however, there are some additional requirements under the CARF. In addition, to reduce the tax compliance burden, there will be mechanisms available to avoid duplication between the CARF and the CRS framework.

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Reportable assets - Crypto-Assets refers to the use of cryptographically secured distributed ledger technology or similar technology and targets the assets that can be held and transferred in a decentralised manner, without the intervention of traditional financial intermediaries which includes stablecoins, NFTs.

Entities required to report - intermediaries which provide services effectuating crypto-asset transactions for or on behalf of customers (eg, crypto-assets exchanges, brokers and dealers in crypto-assets, wallet providers) would be regarded as reporting intermediaries under the CARF - although Central Bank Digital Currencies and some Specified Electronic Money Products are within the CRS rather than the CARF.

Reportable transactions - the reporting intermediaries are required to report (i) exchanges between crypto-assets and fiat currencies; (ii) exchanges between one or more forms of crypto-assets; (iii) transfer of crypto-assets in consideration of goods or services (with minimum thresholds) and (iv) transfers of crypto-assets (even with no knowledge of consideration paid or received). These transactions will be reported on an aggregate basis by type of crypto-assets and distinguishing outward and inward transactions.

Amongst other details, gross sale proceeds (net of transaction fees) together with the fair market value of the transactions; and to enhance the usability of the data, the reporting intermediaries are also required to categorise the transactions into different transfer types (e.g. airdrops, loans) where applicable.

Due diligence - reporting intermediaries are required to carry out due diligence procedures on their customers. The due diligence procedures under the CARF will build on the current CRS due diligence rules to minimise the administrative burden to the reporting intermediaries. However, the proposed rules on the self-certification form make clear if the form is not obtained on opening (and for pre-existing accounts, within 12 months from the start of regime) then the intermediary must obtain the form before providing further services.

Overview of the proposed amendments to the CRS

The OECD also updated the current CRS framework, including widening the definition of “financial asset” to capture digital financial products, and to improve on how the CRS operates. Other amendments include:

Reportable assets - digital financial products including e-money products, digital fiat currency issued by a central bank, digital representations of a single fiat currency will now be covered. Depositary entities under the CRS are also expanded to include digital financial products providers. The scope of derivatives under the CRS is also expanded to derivative contracts referencing crypto-assets, as is the scope of investment entities which will include investment entities carrying out activities of investing in crypto-assets.

Expansion of reporting requirements - reporting under the CRS is expanded to cover (i) the role of controlling person in relation to the entity account holder, (ii) declaration of whether the account is a pre-existing or new account and whether a valid self-certification has been obtained, (iii) whether the account is a joint account and the number of joint holders, and (iv) the type of financial account.

Updates to due diligence procedures - For cases where a valid self-certification was not obtained for pre-existing accounts, reporting financial institutions are required to temporarily determine the residence of the account holders and/or controlling persons as part of the due diligence procedures.

The frequently-asked questions published on the OECD website in respect of further guidance on the interpretation of the CRS will be incorporated in the amended framework. This will also include the OECD guidance on Residence/Citizenship by investment schemes - which mainly relate to residence schemes for individuals based on their economic contributions to a jurisdiction.

The amended CRS framework contains an optional new non-reporting financial institution category for genuine non-profit entities which is subject to sufficient verification procedures to be carried out by the tax administrations.

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What's next

The OECD is currently working on the implementation package of the CARF which will consist of:

- IT solutions to support the exchange of information;
- further elaboration of the rules and administration of the CARF; and
- a framework for bilateral or multilateral competent authority agreements or arrangements for the automatic exchange of information collected under the CARF.

After the release of the implementation package of the CARF, we expect the Hong Kong Government to implement legislation to bring the CARF (including penalties) into effect in Hong Kong. This should include mechanisms to automatically exchange information under the amended CRS framework.

In-scope reporting financial institutions and intermediaries in Hong Kong should closely monitor the developments in this area. In particular, crypto-assets exchanges, brokers and dealers in crypto-assets and wallet providers should start assessing the potential impact of the CARF due diligence and reporting requirements to their business model, including rationalisation of reporting entities, and the adequacy of their IT systems to support the reporting requirements.

Other financial institutions should also review their CRS policies and procedures to start mapping out gaps with the amended framework and plan for potential customer outreach.

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