



Who will be in scope of the AEoI?

**Look-through approach to
foundations, trusts and domiciliary
companies under the Automatic
Exchange of Information (AEoI)**

by Jürg Birri und Philipp Zünd

March 2016

kpmg.ch



The purpose of the Automatic Exchange of Information (AEOI) is the prevention of tax evasion by holding assets abroad. This goal can only be reached if all tax payers with assets abroad are reported, i.e. the AEOI can not be circumvented. The deliberations below explain how the AEOI standard achieved this goal also for wealth management structures.

1. Wealth management structures under current tax treaties

After the EU Savings Tax Agreement¹ entered into force on 1 July 2005, it soon became apparent that it was easy to circumvent. As the EU Savings Tax Agreement only targeted natural persons who were bank clients but not others, such as, for instance, the beneficial owners of foundations, the treaty could easily be circumvented, especially by interposing a foundation.

To close such loop holes, the Withholding Tax Agreements that Switzerland signed with the United Kingdom and Austria² also require identifying the beneficial owners of wealth management structures such as foundations and trusts. However, the treaties still contained tax loop holes as they did not include certain types of discretionary structures³. Even if such non-inclusions were basically justified – such structures are not treated transparently in UK or Austrian law either – these exceptions facilitated the circumvention of the Tax Agreements.

It was this background that prompted the OECD to come up with the AEOI standard, which requires the identification and reporting of all Controlling Persons (see Section 2.3.3 below) of wealth management structures, in some cases (maybe) overreaching its goals a bit.

2. Reportable accounts under the AEOI

2.1. General information

Under the AEOI, Financial Institutions⁴, i.e. banks, certain

types of insurance companies⁵ and investment entities are required to report all accounts subject to reporting.

Reportable accounts are accounts held by persons or Passive Non-Financial Entities (NFEs) with Controlling Persons resident in an AEOI partner country (definition of NFE, cf. Section 2.3.2 below)⁶. Persons subject to reporting are any

persons domiciled in an AEOI partner state (reportable jurisdiction)⁷. As such, not only natural persons domiciled in an AEOI partner state but also operative and non-operative companies and persons controlling Passive NFEs (such as foundations, trusts and domiciliary companies) fall into the scope of the AEOI. The only types of exceptions granted by the AEOI standard are exchange-listed companies, public legal entities and similar⁸. Switzerland's AEOI partner states are deemed to be all countries with which Switzerland has signed an AEOI treaty, as will probably be the case with the EU member states (incl. Gibraltar), Australia, Canada, Guernsey, Iceland, Isle of Man, Japan, Jersey, Norway and South Korea as of 2017⁹.

"If a fiduciary who is a natural person holds an account on behalf of a person domiciled in an AEOI partner state, this other person must be reported under the AEOI regime."

2.2. Account holders as persons subject to reporting

As described above, accounts are reported if the account holder (natural person or legal entity) is domiciled in an AEOI partner state. An account holder is deemed to be anyone who is listed by the Financial Institution as the person in whose name the account is being maintained¹⁰.

However, the Common Reporting Standard (CRS) contains an important exception in Section VIII.E.1: If an account is held

¹ Agreement between the Swiss Confederation and the European Union on regulations which are equivalent to those of defined in Directive 2003/48/EC on taxation of savings income, dated 26 October 2004 (SR 0.641.926.81).

² Agreement between the Swiss Confederation and the United Kingdom of Great Britain and Northern Ireland on the Collaboration in Tax Matters (SR 0.672.936.74; "UK Tax Agreement"); Agreement between the Swiss Confederation and the Republic of Austria on the Collaboration in Tax and Finance Matters (SR 0.672.916.33; "AT Tax Agreement").

³ Art. 2 para. 1 lit. h UK Tax Agreement, Art. 2 lit. h AT Tax Agreement

⁴ Section VIII.A.3 Common Reporting Standard (CRS)

⁵ Regarding the recording of insurance companies under the AEOI, cf. also: Sascha Stojanovic, AIA in Steuersachen – Bedeutung für Schweizer Versicherer, in: Der Schweizer Treuhänder 2015, p. 512 et seqq.

⁶ Section VIII.D.1 CRS

⁷ Section VIII.D.2 CRS

⁸ Section VIII.D.2 CRS

⁹ The relevant treaties with Australia and the EU have already been submitted to the Parliament for approval together with a dispatch. For Canada, Japan, South Korea and the remaining countries the consultations have been initiated.

¹⁰ Section VIII.E.1 CRS

by a person (that is not a Financial Institution) that acts as a fiduciary on behalf of another person, this other person is deemed to be the account holder. Therefore, if a fiduciary who is a natural person holds an account on behalf of a person domiciled in an AEol partner state, this other person (i.e. the beneficial owner) must be reported under the AEol regime.

Should the fiduciary or similar qualify as a Financial Institution, the account-keeping bank is not required to report the beneficial owner, as this is then the duty of the fiduciary which acts as a Financial Institution.

2.3 Controlling persons of passive NFEs subject to the reporting

2.3.1 General aspects

An account-keeping bank is only obliged to report Passive NFEs, such as foundations, trusts or domiciliary companies if these do not qualify as Investment Entities (Financial Institutions, also see Section 2.3.4). For the following statements, it is assumed that the wealth management structure is a Passive NFE, not a Financial Institution.

In such a case, not only the Controlling Persons of the Passive NFE are subject to reporting to their tax domicile but also the Passive NFE itself must be reported in the domicile state (cf. the example in Figure 1).

2.3.2 Passive NFEs

Under the AEol regime, only the Controlling Persons of Passive NFEs are reported but not those of Active NFEs. Therefore, the first step should be to determine which legal entities are Passive NFEs: Passive NFEs are legal entities which do not qualify as Active NFEs, as well as Investment Entities which are not domiciled in an AEol partner state (also see Section 2.3.4 below)¹¹. Specifically, those legal entities are deemed to be Active NFEs if they pass the Gross Income Test (more than 50% of their income derive from non-investment income) and the Asset Test (less than 50% of their assets are held for the production of passive income)¹². Especially also exchange-listed companies (including group companies) and charitable organizations are considered to be Active NFEs¹³.

2.3.3 Controlling persons of passive NFEs

2.3.3.1 Definition according to the CRS

In order to prevent the circumvention of the AEol by using wealth management structures, i.e. Passive NFEs, the CRS contains a very broad definition of Controlling Person (Section VIII.D.6 CRS):

“The term ‘Controlling Persons’ means the natural persons who exercise control over an Entity. In the case of a trust, such term means the settlor, the trustees, the protector (if any), the beneficiaries or class of beneficiaries, and any other natural person exercising ultimate effective control over the trust, and in the case of a legal arrangement other than a trust, such term means persons in equivalent or similar positions.”

The OECD commentary on the CRS goes even further in

this respect and deems the settlor, the trustee, the protectors (if any) and the beneficiaries to be Controlling Persons, regardless of whether they actually control the trust as Controlling Person¹⁴.

As a result, discretionary beneficiaries, who have not yet received any distributions from the trust or the foundation, must also be reported under AEol (also see case study). The commentary at least mentions that in the case of discretionary structures where the beneficiaries’ names are not known to the account-keeping bank, the bank is not obliged to investigate the names in order to report these to the domicile country. However, as soon as these persons receive distributions, the bank must

identify reportable information on the beneficiaries¹⁵. For Example, if the trust does not disclose the names of the beneficiaries and only provides an abstract definition e.g. “children of the settlor” on the form T, the children will only have to be actually identified once they start receiving any distributions, as before that the bank is not aware of who they are. On the other hand, if the specific names of the beneficiaries are mentioned, these discretionary beneficiaries must be reported even if they have not received any distributions (also see the exception listed in Section 2.3.3.2). While the OECD commentary¹⁶ on shareholders of companies as Controlling Persons as a rule considers equity holdings of 25% as defining, the commentary does not mention any such threshold for Controlling Persons otherwise.

“In order to prevent the circumvention of the AEol by using wealth management structures, i.e. passive NFEs, the CRS contains a very broad definition of Controlling Person.”

¹¹ Section VIII.D.8 CRS

¹² Section VIII.D.9.a CRS

¹³ Section VIII.D.9.b and h CRS

¹⁴ OECD commentary on Section VIII, margin no. 134

¹⁵ OECD commentary on Section VIII, margin no. 134

¹⁶ OECD commentary on Section VIII, margin no. 133

Figure 1: Example

Eiger Trust, which was incorporated according to Liechtenstein law, holds an account (no asset management mandate) with Bank B in Switzerland. Bank B knows the following facts about Eiger Trust:

- The trust's settlor is domiciled in France.
- According to form T, the discretionary beneficiaries are the two children domiciled in Germany and listed by name who so far have not yet received any distributions from the trust.
- The protector is domiciled in Switzerland. The trustee is domiciled in Liechtenstein.
- Annual gross income for 2017 is CHF 200,000 and the year's end balance for 2017 is CHF 5m.
- As Eiger Trust is not managed by a Financial Institution, it qualifies as a passive NFE.

Under the AEOI, Bank B will have to report the following persons

Settlor

Regarding the settlor who is a Controlling Person, the following data is reported to the tax authorities in France in 2018 through the Swiss Federal Tax Administration: name, address, tax domicile, tax identification number (TIN), date of birth, role as the trust's settlor, account number, name of Bank B, gross income of CHF 200,000, balance of CHF 5m.

Beneficiaries

Regarding the beneficiaries, the following data is forwarded to the tax authorities in Germany in 2018 through the Swiss Federal Tax Administration: Apart from the personal information mentioned above, the Swiss Federal Tax Administration will also state their role as beneficiaries, the gross income of CHF 200,000 as well as the balance of CHF 5m. Therefore, the total income as well as the total balance are mentioned for both beneficiaries. This is regardless of whether the two children have actually received any distributions.

As an alternative, Bank B may make use of the exceptional provision stated in art. 9 para. 2 AEOI Act (see Section 2.3.3.2) and define the group of beneficiaries in the same way a trust would if it qualified as a Financial Institution.

If the bank were to make use of this exceptional provision, the two beneficiaries would not be reported to Germany for the years in which no distributions are made. However, the bank would have to implement organizational measures to determine any distributions made. In the years in which the beneficiaries receive distributions, the bank would not just report the distributions but again the total income and the total balance.

Protector

According to the CRS, the protector is also deemed a Controlling Person. However, because in this case this person is domiciled in Switzerland, it would not be affected by the AEOI.

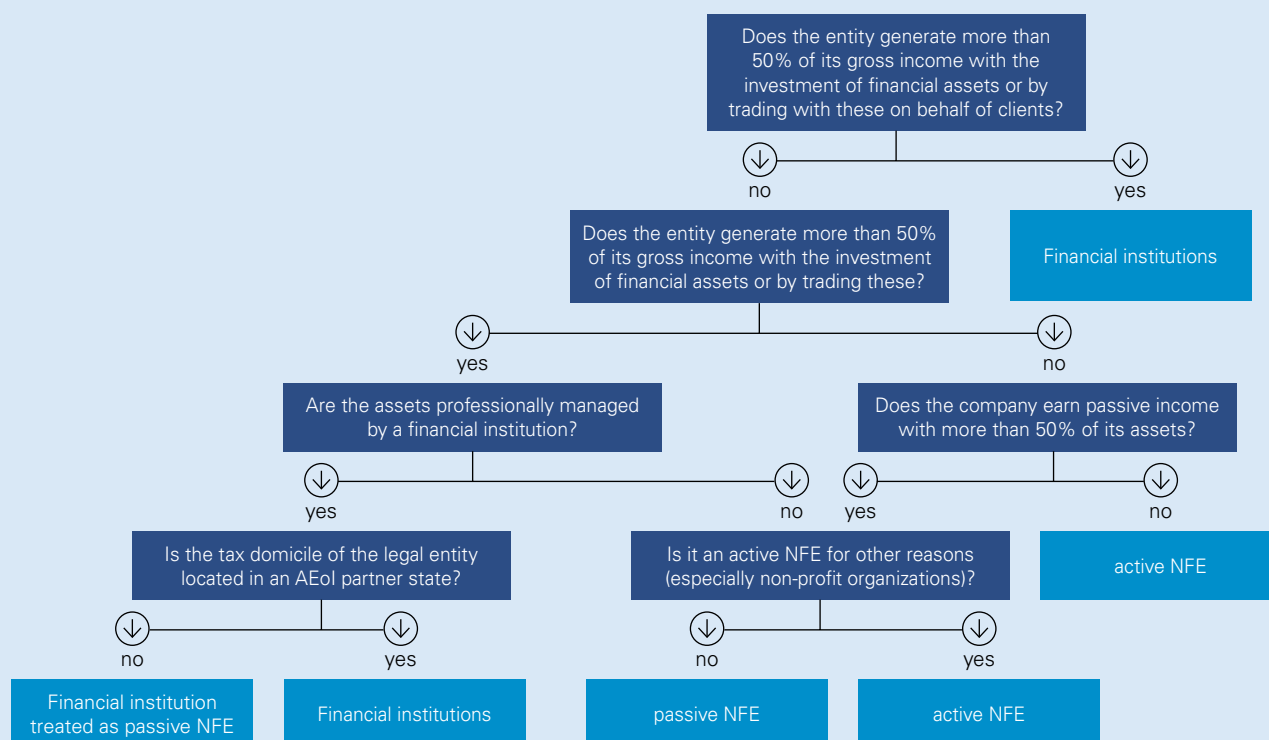
Trustee

The trustee is also deemed to be a Controlling Person included in the AEOI. As soon as Switzerland has an AEOI agreement with Liechtenstein in place, the above-mentioned information (e.g. name, address, the role as trustee, CHF 200,000 as gross income and CHF 5m as total balance) will be reported to Liechtenstein.

Eiger Trust

As soon as Switzerland has an AEOI agreement with Liechtenstein in place, this also triggers a reporting to the Liechtenstein authorities that Eiger Trust has an account at Bank B. Again, the amounts reported would be CHF 200,000 as gross income and CHF 5m as balance. On the other hand, Liechtenstein would for instance not be informed where the beneficiaries are domiciled.

Figure 2: Decision tree to determine the aeoi status of asset management structures



2.3.3.2 Separate rules for trusts, which qualify as Investment Entities (Financial Institution).

If a trust qualifies as Investment Entity and therefore as Financial Institution, it is no longer the account-keeping bank which needs to report the Controlling Persons. Instead, the trust does this itself (also see Section 2.3.4 below). The rules on which Controlling Persons must be reported by the trust deviate slightly from the case where the bank handles this.

According to the AEol Act¹⁷, banks may determine the beneficiaries of trusts in the same way as trusts which qualify as Investment Entities and which, under AEol, would have to report this information themselves. However, this requires that banks undertake adequate organizational measures to ensure that they can identify the distributions made to beneficiaries.

This condition is an imperative as, according to the AEol standard¹⁸, trusts which qualify as Investment Entities only

need to report discretionary beneficiaries in the years they actually receive distributions. This then is the decisive difference when the trust itself and not the bank has to

report the Controlling Persons. The reason why a trust deemed to be a Financial Institution only needs to report discretionary beneficiaries in the years when they receive distributions is that the trustee in principle knows of the distributions. For banks, it is more difficult to know when a trust distributes assets which is why the AEol foresees wholesale reporting, regardless of whether distributions have been made or not.

Accordingly, a bank can only make use of these exceptional provisions if it disposes of the proper organizational measures to detect distributions to beneficiaries. It is not yet clear what these measures will be exactly. But it

is possible that the banks will oblige the trustee to inform them of distributions made and/or have all payments made from the relevant account be checked on a mandatory basis.

"AEol affects all Controlling Persons of wealth management structures such as foundations and domiciliary companies, not only beneficial owners."

¹⁷ Art. 9 para. 2 AEol law (<https://www.admin.ch/opc/de/federal-gazette/2015/9603.pdf>)

¹⁸ OECD commentary on Section VIII, margin no. 70

2.3.3.3 Interim conclusion

For wealth management structures, banks must report all of the Controlling Persons to the relevant tax jurisdiction through the Swiss Federal Tax Administration, i.e. not only the beneficial owners but for instance also the settlor and the protectors. In doing so, it does not matter whether the structure is making distributions to beneficiaries or not. As an alternative, banks may use the rules applicable to trusts which qualify as Financial Institutions. However, the law does not specifically mention foundations in this connection. When applying the alternative, also beneficiaries known by name must be reported only in the years when they receive distributions. However, it is our understanding the bank will not report the actual distributions but the total balance as well as the gross income and gross sales proceeds on the depository account¹⁹. On the other hand, the reporting trust itself would report only the distributions but not the actual income or sales proceeds²⁰.

2.3.4 Wealth management structures qualifying as Investment Entities (Financial Institutions)

According to the CRS, trusts, foundations and domiciliary companies qualify as Investment Entities and therefore as Financial Institutions if their gross income mainly derives from the investment in financial assets (Gross Income Test) and if the entity is managed by another entity which is a Financial Institution (Managed by Test) (Figure 2)²¹. As wealth management structure's income is usually generated by holding assets, the question whether assets are managed by a Financial Institution is a decisive aspect. A

structure is already considered to be managed by a Financial Institution if it has a discretionary wealth management mandate with a bank²². The rule that the account-keeping bank does not need to report the Controlling Persons of a wealth management structure deemed to be a Financial Institution is only applicable if this structure is domiciled in an AEoI Partner Jurisdiction. However, certain states may apply a broader definition of the term "Partner Jurisdiction" and also include states with which they have not yet concluded (but likely in the future) an AEoI agreement. The following example illustrates this:

The Matterhorn Foundation domiciled in Liechtenstein holds a depository account (discretionary wealth management mandate) at Bank A in Switzerland. The foundation's Controlling Persons (founder and beneficiaries) live in Germany. Because of its asset management mandate with Bank A, the foundation qualifies as an Investment Entity and is therefore obliged to report the founder and beneficiaries itself under the AEoI regime. However, as long as Switzerland has not concluded an AEoI agreement with Liechtenstein or defines Liechtenstein in the AEoI ordinance as Participating Jurisdiction, Bank A is obliged to report the Controlling Persons to Germany.

As soon as Switzerland signs an AEoI agreement with Liechtenstein or defines Liechtenstein as a Participating Jurisdiction, the bank no longer has to report the Controlling Persons. Hereby it does not matter whether Liechtenstein in turn also has an agreement with Germany or not, i.e. the foundation effectively reports all Controlling Persons to Germany.

¹⁹ Section I.A.4, 5 and 6 CRS, OECD commentary on Section I, margin no. 13

²⁰ Section I.A.4 and 7 CRS, OECD commentary on Section I, margin no. 13

²¹ Section VIII.A.6.b CRS

²² OECD commentary on Section VIII, margin no. 17



Conclusion

The AEoI affects all Controlling Persons of wealth management structures, such as trusts, foundations and domiciliary companies, not only the beneficial owners (cf. also example in Figure 1). Because the reporting regime is cast so wide, it is hard to circumvent the AEoI using structures. Even persons that may not be liable to pay taxes in that relevant domicile jurisdiction may have to be reported. This is especially true for discretionary beneficiaries who do not receive any distributions. It is therefore even more important that all of the persons involved in structures (for instance, the account-keeping bank, an asset manager or a foundation board member) grapple with the details of who needs to be reported under the AEoI regime. Specifically, it must also be

clarified whether it might not be better if the wealth management structure itself reports under the AEoI regime instead of the account-keeping bank (or vice-versa). And finally, it must be ensured that all of the reported persons are fully tax compliant. This is also important because certain countries have on-going voluntary tax disclosures in place¹ and because there is already tax transparency today (specifically group requests²).

¹ Also see www.kpmg.ch/voluntarydisclosures

² Philipp Zünd, Non-tax compliant clients can be caught by group requests: <http://blog.kpmg.ch/non-tax-compliant-clients-can-be-caught-by-group-requests/>

Contact

KPMG AG

Badenerstrasse 172
PO Box
8036 Zurich

kpmg.ch

Jürg Birri

Partner
Financial Services

+41 58 249 35 48
jbirri@kpmg.com

Philipp Zünd

Senior Manager
Financial Services

+41 58 249 42 31
pzuend@kpmg.com

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received, or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2016 KPMG AG is a subsidiary of KPMG Holding AG, which is a member of the KPMG network of independent firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss legal entity. All rights reserved.