



A PRACTICAL REVIEW OF
THE COMMON REPORTING STANDARD
(CRS)

2016



Contents	Page
A. INTRODUCTION	3
B. THE PRACTICE.....	3
C. ENTITY CLASSIFICATION.....	4
D. EXAMPLES.....	8
E. CONCLUSION.....	9
F. HOW KINANIS LLC CAN ASSIST	10

A. INTRODUCTION

The Common Reporting Standard (CRS) has been initiated by the Organization for Economic Cooperation and Development (OECD) aiming at improving international tax compliance and preventing tax evasion, through the automatic exchange of information between the countries that implement CRS. The participating countries are listed in ***Appendix I***.

Although the CRS was largely based on the FATCA Model 1 IGA, there are many differences between the two reporting regimes. Please refer to ***Appendix II***.

The CRS is applied by all authorized credit institutions and other financial institutions, which are located in countries that participate in the CRS, and applies to all account (individuals and entities). It requires the financial institutions that are in countries which implement the CRS, to submit information on financial accounts that are held by account holders who are tax residents of countries which implement CRS.

B. THE PRACTICE

For the purpose of identifying tax residence, the financial institutions are required to obtain from the direct and indirect account holders, self-certifications which include the country of tax residence and tax identification number(s) as well as the Entity's classification, if the account holder is an Entity.

If the information collected by the financial institutions indicates that the account holder (individual or Entity) is resident in a reportable jurisdiction, the reporting financial institution must treat the account as a reportable account and information will be shared with the country in which the individual or Entity is a tax resident. In some cases, depending on the classification given to the Entity, the standard requires to look through the Entity and report on the individuals that ultimately control the Entity (controlling persons). This is explained in more detail in section C of this report.

Without the self-certification, the financial institution cannot open any new account and in the case of pre-existing accounts, if no self-certification is provided the financial institutions are obliged to consider the account holders as reportable persons. As a

consequence, financial institutions will report to the Tax Department the information they already have for the undocumented accounts and The Tax Department will in turn forward the information to the foreign tax authorities.

The first reporting in Cyprus will occur in 2017 and will cover the year 2016.

C. ENTITY CLASSIFICATION

The CRS provides a wide definition of the term "Entity" which includes all types of corporate vehicles, trusts, partnerships and other similar structures.

All Entities need to be classified under CRS and this classification will determine whether the controlling persons of the Entity would have to be identified and reporter or not. The first classification that needs to be made is whether the Entity is a Financial Institution (FI) or a Non-Financial Entity (NFE).

Financial Institutions (FI)

The term Financial Institution means a Custodial Institution, a Depository Institution, an Investment Entity, or a Specified Insurance Company.

Custodial Institution means any Entity that holds, as a substantial portion of its business, Financial Assets for the account of others. An Entity holds Financial Assets for the account of others as a substantial portion of its business if the Entity's gross income attributable to the holding of Financial Assets and related financial services equals or exceeds 20% of the Entity's gross income during the shorter of:

- (i) the three-year period that ends on 31 December (or the final day of a non-calendar year accounting period) prior to the year in which the determination is being made; or
- (ii) the period during which the Entity has been in existence.

Depository Institution means any Entity that accepts deposits in the ordinary course of a banking or similar business.

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.

Non-Financial Institutions (NFE)

Entities that do not fit any of the FI definitions are likely to be either Active Non-Financial Entities (**Active NFE**) or Passive Non-Financial Entities (**Passive NFE**).

For Active NFEs the reporting will be done in the jurisdiction where the Entity is a tax resident, while for Passive NFEs there is a requirement to look through the Entity so that the reporting will be done in the jurisdiction where the controlling person is a tax resident.

The Controlling Persons of an Entity are the natural persons (that means people, rather than organisations) who have control over your Entity. An Entity may have several Controlling Persons. Generally, the person who has control over an Entity is the one who has a controlling ownership interest. Typically, this means that they own a certain percentage, for example, 25% of the Entity.

An Entity will be classified as **Active NFE** if it meets any of the following criteria:

a) less than 50% of the NFE's gross income for the preceding calendar year or other appropriate reporting period is *passive income** and less than 50% of the assets held by the NFE during the preceding calendar year or other appropriate reporting period are assets that produce or are held for the production of passive income;

b) the stock of the NFE is regularly traded on an established securities market or the NFE is a Related Entity of an Entity the stock of which is regularly traded on an established securities market;

c) the NFE is a Governmental Entity, an International Organisation, a Central Bank, or an Entity wholly owned by one or more of the foregoing;

d) substantially all of the activities of the NFE consist of holding (in whole or in part) the outstanding stock of, or providing financing and services to, one or more subsidiaries that engage in trades or businesses other than the business of a Financial Institution, except that an Entity does not qualify for this status if the Entity functions (or holds itself out) as an investment fund, such as a private equity fund, venture capital fund, leveraged buyout fund, or any investment vehicle whose purpose is to acquire or fund companies and then hold interests in those companies as capital assets for investment purposes;

e) the NFE is not yet operating a business and has no prior operating history, (a "start-up NFE") but is investing capital into assets with the intent to operate a business other than that of a Financial Institution, provided that the NFE does not qualify for this exception after the date that is 24 months after the date of the initial organisation of the NFE;

* Passive income would include the portion of gross income that consists of: a) dividends; b) interest; c) income equivalent to interest; d) rents and royalties, other than rents and royalties derived in the course of carrying out active business, at least in part by employees of the NFE; e) annuities; f) the excess of gains over losses from the sale or exchange of Financial Assets that gives rise to the passive income we described earlier; g) the excess of gains over losses from transactions (including futures, forwards, options, and similar transactions) in any Financial Assets; h) the excess of foreign currency gains over foreign currency losses; i) net income from swaps; or j) amounts received under cash value insurance contracts.

f) the NFE was not a Financial Institution in the past five years, and is in the process of liquidating its assets or is reorganising with the intent to continue or recommence operations in a business other than that of a Financial Institution;

g) the NFE primarily engages in financing and hedging transactions with, or for, Related Entities that are not Financial Institutions, and does not provide financing or hedging services to any Entity that is not a Related Entity, provided that the group of any such Related Entities is primarily engaged in a business other than that of a Financial Institution;
or

h) the NFE meets all of the following requirements (a "non-profit NFE") : (i) it is established and operated in its jurisdiction of residence exclusively for religious, charitable, scientific, artistic, cultural, athletic, or educational purposes; or it is established and operated in its jurisdiction of residence and it is a professional organisation, business league, chamber of commerce, labour organisation, agricultural or horticultural organisation, civic league or an organisation operated exclusively for the promotion of social welfare;

(ii) it is exempt from income tax in its jurisdiction of residence; (iii) it has no shareholders or members who have a proprietary or beneficial interest in its income or assets; (iv) the applicable laws of the NFE's jurisdiction of residence or the NFE's formation documents do not permit any income or assets of the NFE to be distributed to, or applied for the benefit of, a private person or non-charitable Entity other than pursuant to the conduct of the NFE's charitable activities, or as payment of reasonable compensation for services rendered, or as payment representing the fair market value of property which the NFE has purchased; and (v) the applicable laws of the NFE's jurisdiction of residence or the NFE's formation documents require that, upon the NFE's liquidation or dissolution, all of its assets be distributed to a Governmental Entity or other non-profit organisation, or escheat to the government of the NFE's jurisdiction of residence or any political subdivision.

Under the CRS, a **Passive NFE** means any: (i) NFE that is not an Active NFE; and (ii) Investment Entity located in a Non-Participating Jurisdiction and managed by another Financial Institution.

In section D of this report we provide examples on how to classify a Company for better understanding.

D. EXAMPLES

1. Investment Portfolio Company:

Investment Company's Y majority income is derived from investing, re-investing and trading in financial assets and these financial assets are managed by a bank or asset manager based on a discretionary asset management mandate. Investment Company Y qualifies as **Financial Institution** based on the "Investment Entity" definition. In the absence of a discretionary investment mandate agreement, Investment Company Y will be classified as a **Passive NFE** since the majority of its income represents passive income.

2. Holding Company that is a member of a non-financial group:

Holding Company X is the parent entity of 3 subsidiaries that are in the business of operating grain terminals. The sole activity of Holding Company X is to hold the stock of these subsidiary companies. Holding Company X is privately owned and is not traded on an established securities market. Holding Company X was formed as part of the original structure of the business and was not formed in connection with any sort of investment purpose such as private equity, venture capital, etc. Holding Company X qualifies as **Active NFE** as the company's primary purpose is to hold the stock of its subsidiaries and these subsidiaries are engaged in a business that is not financial in nature.

3. Active Trading Company:

Company's F business consists of production of fertilizers. Company F has been very successful over the last five years and has been able to invest its profits into securities. Therefore, in addition to income received from the sale fertilizers, Company F also earns passive income (i.e. interest and dividends) on its investments. In the prior year, Company F earned gross income of EUR 1,000,000 from the sale of fertilizers and EUR 50,000 of interest and dividends on its investments. On December 31 of the prior year, Company F had assets of EUR 20,000,000 of which EUR 2,000,000 is invested into securities and the remaining EUR 18,000,000 consists of equipment, inventory and other assets that are used in the daily production of the fertilizers. Company F qualifies as an **Active NFE** by reason of income and assets because less than 50% ($50,000 / 1,050,000 = 4.76\%$) of the gross income in the prior year is Passive Income and less than 50%

(2,000,000 / 20,000,000 = 10%) of the assets held produce or are held for the production of Passive Income.

4. Real Estate Company:

Company R does not engage in active business but only invests in real estate and receives rental income and/or realises capital gains on the sale of such property. Company R would be a **Passive NFE** since more than 50% of its total income is passive income and/or more than 50% of its total assets are assets that produce or may produce passive income.

5. Financing Company:

The principal activity of Company F is the provision of financing to other related entities which are non-financial. Company F should be classified as **Active NFE**, since the company's income is primarily derived from the provision of loans to non-FI related entities which are not part of a Financial Group. If Company F also provides loans to unrelated parties and the interest received from this type of loans is greater than Company's F active income, Company F may be classified as a **Financial Institution**.

E. CONCLUSION

In broad terms, financial institutions report information to the tax office of the jurisdiction in which they are located. The information consists of details of financial assets they hold on behalf of taxpayers (individual or entities) from jurisdictions with which their tax office will exchange information. This process requires high level of regulations and the ability to correctly classify each entity either as Financial Institution, Active NFE or Passive NFE and which will also determine whether the beneficiaries are reportable or not. For this reason it is necessary to have solid tax advice that will do a holistic review of each entity's characteristics.

F. HOW KINANIS LLC CAN ASSIST

- Prepare financial statements which are necessary to the Entity's classification
- Determine the Entity's classification (Financial Institution, Active or Passive NFE) and provide all necessary documents to the bank for this purpose
- Provide tax advice / tax planning

Disclaimer

This publication has been prepared as a general guide and for information purposes only. It is not a substitution for professional advice. One must not rely on it without receiving independent advice based on the particular facts of his/her own case. No responsibility can be accepted by the authors or the publishers for any loss occasioned by acting or refraining from acting on the basis of this publication.

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APPENDIX I: STATUS OF COMMITMENTS (101 jurisdictions have committed)

JURISDICTIONS UNDERTAKING FIRST EXCHANGES BY 2017 (54)

Anguilla, Argentina, Barbados, Belgium, Bermuda, British Virgin Islands, Bulgaria, Cayman Islands, Colombia, Croatia, Curaçao, Cyprus, Czech Republic, Denmark, Estonia, Faroe Islands, Finland, France, Germany, Gibraltar, Greece, Greenland, Guernsey, Hungary, Iceland, India, Ireland, Isle of Man, Italy, Jersey, Korea, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mexico, Montserrat, Netherlands, Niue, Norway, Poland, Portugal, Romania, San Marino, Seychelles, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Trinidad and Tobago, Turks and Caicos Islands, United Kingdom

JURISDICTIONS UNDERTAKING FIRST EXCHANGES BY 2018 (47)

Albania, Andorra, Antigua and Barbuda, Aruba, Australia, Austria, The Bahamas, Bahrain, Belize, Brazil, Brunei Darussalam, Canada, Chile, China, Cook Islands, Costa Rica, Dominica, Ghana, Grenada, Hong Kong (China), Indonesia, Israel, Japan, Kuwait, Lebanon, Marshall Islands, Macao (China), Malaysia, Mauritius, Monaco, Nauru, New Zealand, Panama, Qatar, Russia, Saint Kitts and Nevis, Samoa, Saint Lucia, Saint Vincent and the Grenadines, Saudi Arabia, Singapore, Sint Maarten, Switzerland, Turkey, United Arab Emirates, Uruguay, Vanuatu

APPENDIX II: FATCA Vs CRS

	FATCA	CRS
For Governing Authority	United States	Separate participating tax jurisdictions
Withholding	30% withholding on Non-Compliant Payees / Intermediaries	No Withholding
Account Scope	US Individual Accounts, US Entity Accounts and Passive NFFE accounts held by substantial US owners	Individual and Entity accounts held by tax residents of any CRS participating jurisdiction or Passive NFEs with Controlling persons that are resident in any CRS participating jurisdiction
Thresholds	New Individual: \$50,000 New Entity: N/A Preexisting Individual: \$50,000 (generally) and \$250,000 (cash value insurance) Preexisting Entity: \$250,000	If the domestic country allows, and the individual financial institution elects to apply it, preexisting Entity accounts below 250,000 US dollars (or local currency equivalent) are not subject to review until such time as the account exceeds US\$250,000 at a subsequent year end. That is allowed by Cyprus legislation.
Documentation Requirements	Forms W-8/ W-9 may be used to capture all tax data	U.S. Tax Forms are not acceptable to capture all CRS data (e.g. multiple tax residences, CRS legal Entity classification); CRS self-certifications must be developed
New Accounts of Preexisting Account Holders	Allowed to treat new accounts of preexisting clients as preexisting accounts IF Financial Institution is permitted to satisfy such AML/KYC Procedures for the Financial Account by relying upon the AML/KYC Procedures performed for the Preexisting Account	Same as FATCA and UK CDOT but is not allowed when by instance, the account holder of a preexisting account needs to provide new, additional, or amended customer information (as a result of a legal, regulatory, contractual, operational or any other requirement).
Sponsored Entities	Category available with special rules applicable	Category not available

Our Firm

Kinanis LLC, a law and consulting firm, is one of the leading and largest business law firms in Cyprus and advises for over 30 years the international investor and private clients on all aspects of law, tax and accounting.

Kinanis LLC absorbed the business of its shareholders which are in the legal and consulting profession since 1983, with local and international dimensions.

Experience and practice over the years brought forward the need for transformation from a traditional law firm to a more innovative multidisciplinary firm providing a full range of services combining law and accounting with the extensive expertise in corporate and tax advice to ensure that our clients will obtain the best possible spherical advice adopting the principle as to the services offered "All in one place", so that the client will find a quick, correct and efficient solution to its daily legal, accounting and tax issues in a trustworthy environment.

This combination of legal, accounting and tax services through our well qualified personnel and our involvement and participation in international transactions over the years, have established our firm as one of the key players in the field. Our involvement in international financial transactions has also provided us with the extensive expertise in representing groups, corporations, funds as well as the private client.

The firm is staffed with around 80 young, energetic and ambitious professionals, including lawyers, accountants and administrators who provide prompt, efficient and high quality services and who are capable of meeting the current demanding challenges of the local and international business environment.

We always look to give solutions in a simple and as possible quick way focusing on the needs of each client trying to anticipate the issues before becoming a problem.

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