Common Reporting Standard and EU beneficial ownership registers: inadequate protection of privacy and data protection

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Abstract

This article contains a summary of a technical presentation given on 7 September 2016 to the independent EU data protection body established under article 29 of the EU data protection directive (‘Article 29 Working Party’ a.k.a. ‘WP29’). Like numerous other European privacy and data protection bodies, WP29 raised concerns in the past about the proportionality of the Common Reporting Standard (CRS). The scope of the presentation was to illustrate the actual impact of the CRS based on practical examples analysed in the light of general tax law principles. A similar presentation was made to the Council of Europe’s Bureau of the Consultative Committee of the Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data in June 2016. (The Council of Europe is the platform used by 103 countries to implement the CRS on a multilateral basis.) This note is provided for general information purposes only and it should not be reproduced or copied (in whole or in part) without the written authorization from the author.

Concerns about the general structure of the Common Reporting Standard

The Common Reporting Standard (CRS) is essentially a tax measure that was designed to combat tax evasion in the country of residence of the relevant account holder. As such, any privacy and data protection analysis should take into account specialist insight.

In terms of the CRS’s general structure, I refer in particular to the generalized basis of information exchange and the fact that information is exchanged in a manner that is independent of the detection of any actual risk of tax evasion.

The CRS provides for an exchange of information that is generalized and independent of the detection of any actual risk of tax evasion

It is for data protection authorities to consider technical data protection issues in detail. However, it is noteworthy that the ECJ held as recently as 6 October 2015 that legislation permitting public authorities to have access, on a generalized basis, to the content of electronic communication, without any differentiation, limitation, or exception and without providing for any legal remedies, did not respect the essence of the fundamental rights to privacy and data protection.1

The bigger picture

The commentary published by the Organization for Economic Cooperation and Development (OECD) confirms that the CRS was developed between 2009

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and 2012 with the objective of capturing and exchang- 
ing the maximum amount possible of information, with very little concern for privacy and data protec- 
tion issues.

Outside the field of taxation, the excesses of gener- 
alized data collection and exchange were exposed in 
2013 by Edward Snowden, resulting in a public outcry 
and a counter-revolution to reassert the prevalence of 
the fundamental rights of privacy and data protection. 
In the EU, this culminated in the ECJ’s decision of 6 
October 2015 in the Schrems case and the EU data 
protection reform on 27 April 2016, which was intro- 
duced to ‘allow people to regain control of their per- 
sonal data’. Outside the field of taxation, public 
concerns for the right to privacy and data protection 
have been further strengthened by a number of high- 
profile cases and data breaches that took place at the 
end of 2015 and the beginning of 2016, including the 
Apple v FBI case and the $81m heist against SWIFT.

The broader views of society in relation to privacy 
and data protection appear to be based on two con- 
trasting sentiments depending on whether the debate 
focuses on the field of taxation or not. However, the 
right to privacy is not a relative value. Instead, any 
interference with an individual’s right to privacy has 
to comply with the same requirements of legality, le- 
gitimate interest, and proportionality, as outlined by 
the European Commission’s Article 29 Working Party 
(WP29) in the past.

Data security

Over the past two years, several hacking incidents 
showed the inability of governments and supra- 
national authorities to protect sensitive data of ordi-

nary citizens. In addition to the attack against SWIFT 
(which led to the theft of $91m), it has been reported 
that government authorities in several countries 
(including the USA, Turkey, and the Philippines) 

lost sensitive data (passport details, fingerprints, back- 
ground checks, social security numbers, etc) concern- 
ing tens of millions of citizens to hackers.

Under the CRS, information about:

- the identity (name, tax identification number, date 
  and place of birth); and
- detailed bank account information (account 
  number, account balance, amount of income and 
  sale proceeds, etc) of virtually every individual with 
  a bank account abroad will be captured and 
exchanged electronically between banks and their 
tax authorities, and between tax authorities 
around the globe. This will provide the interna-
tional hacking community, financial criminals, 
and ‘dark web’ users with an unprecedented 
opportunity.

WP29 and other data protection bodies—including 
the European Data Protection Supervisor (EDPS) 
and the Council of Europe’s committee on automatic 
processing of personal data—have already raised ser-
ious concerns in relation to the proportionality of the 
CRS. These include the general and automatic nature 
of information exchange, the fact that automatic ex-
change is independent of the detection of any actual 
risk of tax evasion, and other concerns based on gen-
eral principles of privacy and data protection law.

A ticking bomb

mandatory exchange of information, the group of ex-

perts appointed by the European Commission (‘AEFI 
Group’) issued a stark warning addressed to the EU 
institutions:

On many aspects, DAC2 may be compared with the 

Data Retention Directive which has recently been


3. In an interview with Time Magazine, Apple’s CEO referred to the right to privacy as ‘one of the founding principles of the country’ <http://time.com/4261796/tim-cook-transcript/>. It is noteworthy that a wide segment of public opinion sided with Apple’s controversial decision, showing a single-minded focus on the right to privacy of law-abiding citizens (even if it meant frustrating an investigation in a hideous crime).

4. Since the presentation to WP29, Yahoo! confirmed that the data of 1 billion of its users has been lost to hacking, confirming the data protection concerns surrounding the implementation of the CRS.
declared illegal by the CJEU. DAC2 must respect the principle of proportionality. . . A legal challenge might arise from the current version of DAC2 mainly because of the magnitude of the data to be collected and reported and the fact that it does not guarantee taxpayers a permanent access to their data and a mandatory notification in case of breach. . . In its current version, DAC2 might be challenged because it does not request the existence of such sufficient cause or indicia of unlawful behaviour. . . The AEFI Group is concerned that information exchanged may happen to be irrelevant for taxation purposes in the receiving jurisdiction (home country) under domestic law and that reporting in such cases might be treated as being in breach of data protection law.

On many aspects, the CRS may be compared with the Data Retention Directive which has already been declared illegal by the European Court of Justice

This quest for total transparency first introduced under the CRS seems to have spilled over to the field of public registers of beneficial ownership. Thus, despite the safeguards imposed by the Fourth Anti-Money Laundering Directive of 20 May 2015:

- At the beginning of 2016, the UK introduced public registers of ‘People with Significant Control’ in respect of UK companies and limited liability partnerships (‘PSC registers’) that may be accessed by anyone.
- On 10 May 2016, France introduced a fully public register concerning trusts (since declared unconstitutional by the French Constitutional Council).

On 21 October 2016, The French Constitutional Council declared that France’s public register on trusts was unconstitutional

Political inactivity in relation to the safeguard of fundamental rights in the context of the CRS and public registers requires a vigorous response ahead of the full implementation of the new rules. In the case of the CRS, this will take place at the beginning of 2017 for a number of countries (‘early adopters’), as well as the EU).6

The lack of political engagement is the more perplexing as there are a number of existing alternatives, which would enable countries to combat tax evasion in a proportionate way. These include traditional information exchange mechanism (Article 26 OECD Model Tax Convention), Tax Information Exchange Agreements (existing case law shows that they work) and calibrated automatic exchange agreement that enable taxpayers to choose between exchange of information and a withholding tax that reflects the level of taxation in their home jurisdiction. This is the solution contained in two agreements signed by Switzerland and two EU Member States (Austria and the UK), before the G-20 and the OECD decided to go down the Foreign Account Tax Compliance Act (FATCA) route instead and unleashed the CRS storm.

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Implementation process—current threats

In order to be compatible with the European Human Rights Convention and the EU Charter of Fundamental Rights, an interference with an individual’s right to privacy and data protection must be (i) in accordance with the law; (ii) in pursuit of recognized legitimate aims (which include the prevention of crime); and (iii) necessary in a democratic society.

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Blanket and indiscriminate nature of automatic exchange under CRS—(Proportionality I)

WP29, the EDPS, and the Council of Europe’s T-PD have already identified a number of issues in relation to the proportionality of the CRS. Questions must also be raised in relation to the compatibility of the CRS with the principles laid down in the ECJ’s decision in the Schrems judgment of 6 October 2015, where the ECJ held, inter alia, that:

a. Legislation permitting the public authorities to have access on a generalised basis to the content of electronic communication must be regarded as compromising the essence of the fundamental right to respect of private life;

b. Legislation that authorises storage of all the personal data on a generalised basis, without any differentiation, limitation or exception is not limited to what is strictly necessary.

c. Legislation not providing for any possibility for an individual to pursue legal remedies in order to have access to personal data relating to him, to obtain the rectification or erasure of such data, does not respect the essence of the fundamental right to effective judicial protection, as enshrined in Art. 8 of the European Convention on Human Rights and Art. 47 of the EU Charter of Fundamental Rights. (emphasis added)

Questions must also be raised in relation to the interaction between the CRS and the new EU data protection framework adopted on 27 April 2016, notably the General Data Protection Regulation7 and the Data Protection Directive for the police and criminal justice sector,8 both of which were introduced to ‘allow people to regain control of their personal data’.9

Excessive level of information gathering under CRS—(Proportionality II)

The CRS requires the gathering and exchange of vast amounts of information that is often not foreseeable relevant—or is even outright and clearly irrelevant—to the enforcement of domestic taxes.

Specific concerns about the actual mechanics of the CRS

During the presentation, the author discussed a number of specific CRS scenarios confirm and amplify the existing concerns about the proportionality of the CRS, notably:

a. The exchange of information concerning the value of investments: In circumstances where it is clear that the taxpayer does not owe any tax in his/her country of residence in respect of the value of those investments (eg in countries that do not levy a wealth tax).

b. The exchange of information in relation to taxpayers who benefit from a special tax regime: In circumstances where it is clear that the information exchanged is not relevant in their country of residence in order to determine and monitor their tax liability. During the presentation, the following special tax regimes were considered: (i) ‘cadre étranger’ (Belgium), ‘régime des impatriés’ (France), ‘habitual non-resident’ taxpayers (Portugal), so-called ‘Beckham Law’ (Spain) and the ‘remittance basis’ for ‘non-domiciled’ taxpayers (all European common law jurisdictions, notably Ireland, Malta, Cyprus, and the UK).

c. The exchange of information concerning individuals in relation to companies, trusts, foundations, etc based on a single ‘one-size-fits-all’ concept (ie the concept of ‘Controlling Persons’):

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The concept of ‘Controlling Persons’ (which is absent in FATCA) is independent of any domestic tax attribution rules under domestic law (‘Controlled Foreign Companies’ rules, ‘Transfer of Assets Abroad’ rules, etc) and is at odd with the ECJ case law in this area (notably the Cadbury Schweppes case).

d. Taxpayers without any taxable income/gains in the relevant tax period:

The reporting of the value of the taxpayer’s assets is also not relevant in circumstances where the taxpayer does not have any taxable income and/or gains in the relevant tax period, either in absolute terms or after deduction of expenses/losses in accordance with the domestic rules in the country of residence of the taxpayer.

c. Reporting scenarios in the case of Charities:

Charities are not generally exempt from reporting under the CRS and, in practice, the reporting profile of a charity depends on whether it is:

1. an ‘active non-financial entity’ (active-NFE)—in which case there is no reporting10; or
2. a financial institution—in which case the charity has to report any individual who has an ‘Equity Interest’ in the charity.11

The general nature of information gathering and the automatic nature of information exchange under the CRS may easily translate into a life in danger, regardless of the existence of any tax liability, for charities engaged in work in jurisdictions where the local authorities are resistant or opposed to their activities.

f. The complexity of the drafting technique used in the CRS: The CRS is broadly a derivation of FATCA,12 which a US commentator defined as ‘monstrous’ and ‘daunting even to the most knowledgeable experts [of US tax law]’.13 Over the past year, EU-based banks, account holders, and their advisers are struggling to follow the

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10. The reason for the exclusion of active entities from the scope of the CRS stems from the US FATCA, which was introduced essentially to counter the activities exposed by banking scandals; those showed how private banks helped US taxpayers to hide money and investments behind anonymous accounts—such as numbered accounts and accounts held by offshore companies/trusts and foundations. In other words, the main focus of FATCA (and the CRS) is on ‘empty’/‘passive’/‘secret’ structures, which leaves out ordinary businesses such as an active enterprise.

9. One would expect the term ‘Financial Institution’ to comprise banks and the like, not charities. Again, the reason for the extension of the concept of ‘Financial Institution’ to charities (and other entities) stems from FATCA. FATCA sought to root out the connivance of private banks with US tax fraudsters by introducing a withholding tax of 30% on US investments, which a financial institution (such as a bank) investing on behalf of its clients, could only avoid by registering with the IRS. Under the registration system, the relevant financial institution undertakes to disclose any ‘substantial US owner’ who may owe US tax. Also, by showing its registration number (‘Global Intermediary Identification Number’ or GIIN) to paying agents, the relevant bank may receive payments of dividends, etc without the 30% withholding tax. As FATCA is about registration, certain companies/foundations/trusts, etc may avoid complex reporting by their bank(s) by registering directly with the IRS. In this case, the relevant structure is treated as akin to a financial institution, meaning that any reporting lies with the entity itself (rather than the ‘real’ financial institution, ie the bank). In other words, the entity becomes the relevant ‘Financial Institution’ replacing the ‘ordinary’ financial institutions (banks, etc) in the reporting chain. As FATCA seeks to stamp out secrecy, the system is relatively liberal when it comes to registration by foreign entities (as visibility is key).

Although the CRS system is not based on registration with the tax authorities it has maintained the distinctions introduced by FATCA. This means that certain structures qualify as ‘Financial Institutions’, thus relieving the relevant bank from reporting. Also, while a bank’s reporting relates to its clients (‘Controlling Persons’ in the case of an entity), an entity that is treated as akin to a financial institution has to report on itself. This introduces a separate concept from ‘Controlling Person’, ie the entity has to report any person who has an ‘Equity Interest’ in the structure. The difference between ‘Controlling Person’ and ‘Holder of an Equity Interest’ has caused a lot of confusion, which has been partly fuelled by the OECD. Moreover, as the type of classification shifts the burden of reporting from the bank to the client (and vice versa), discussions with banks ahead of the implementation of the CRS have tended to be quite fractious and divisive (as well as expensive). This topic is addressed further later in this article, as the lack of clarity of the CRS affects its proportionality—a law must be adequately accessible and foreseeable, i.e formulated with sufficient precision to enable the individual to regulate his or her conduct (see Huvig v France, Appl No 11105/84, ECHR, 24 April 1990).

12. The use of concepts such as ‘FI’ (Financial Institution), ‘active NFE’ (active Non-Financial Entity), ‘passive NFE’ (passive Non-Financial Entity), ‘Equity Interest’, etc have been lifted directly from FATCA and have broadly the same meaning. Under FATCA, an FI (Financial Institution) is called an FFI (Foreign Financial Institution), an ‘active NFE’ is called ‘active NFFE’ (active Non-Financial Foreign Entity), a ‘passive NFI’ is called a passive NFFI, etc.

13. FATCA is a Leviathan. And it breathes fire. Its size is monstrous (544 pages long). Moreover, the regulations are painstakingly detailed and excruciatingly technical, a bewildering maze of rules, sub-rules, sub-sub-rules, cross-references, exceptions, exceptions to exceptions and so on. They are daunting even to the most knowledgeable experts.

structure and provisions of what is effectively a complex piece of US law transposed globally.

This raises the question as to whether the limitations to the right to privacy caused by the CRS are ‘in accordance with the law’, that is, whether the CRS is adequately accessible and foreseeable to enable the individual to regulate his or her conduct (as confirmed by case law from the European Court of Human Rights).

g. The abstract nature of the CRS: As a piece of US legislation, FATCA aims at ensuring that any tax liability arisen in accordance with the US tax rules is notified to the IRS. Accordingly, FATCA has been designed to comply with a specific domestic tax system (US tax law). By contrast, the CRS has not been designed with any particular tax system in mind, but broadly as a copycat of FATCA (with few alterations)

By applying a ‘one-size-fits-all’ approach that is independent of any domestic tax system, the CRS results in the exchange of excessive and often irrelevant information. Ultimately, this defeats the CRS’s purpose of combating tax evasion, that is, the evasion of domestic tax laws in the country of residence of the account holder.

h. The arbitrary nature of the CRS: In many instances, the nature and level of reporting depends on the legal structure of the account holder, without any apparent reason for the difference of treatment.

One example: under the UK guidance, a charity may be required to exchange information in respect of people who receive a grant, but only if that charity is organized as a charitable trust (the common law equivalent of a charitable foundation)—and not if it is organized as a charitable company.

i. The existence of a number of substantial contradictions: The CRS contains contradictions in relation to a number of central concepts. In turn, this affects the amount and quality of information subject to information exchange. In particular, the OECD’s Commentary and Implementation Handbook openly contradicts various definitions contained in the CRS (eg in relation to the concepts of ‘Controlling Persons’/holder of an ‘Equity Interest’). These contradictions have a direct effect on the DAC2, raising the question of whether the limitations to the right to privacy operated by the CRS are ‘in accordance with the law’.14

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14. In implementing this Directive, Member States should use the Commentaries on the Model Competent Authority Agreement and Common Reporting Standard, developed by the OECD, as a source of illustration or interpretation and in order to ensure consistency in application across Member States. Union action in this area should continue to take particular account of future developments at OECD level.