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The Rise of Client Tax Reporting in Asia

Alleviating the Client Tax Reporting Burden: How Financial Institutions Can Stand Out

Regulation Asia

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Introduction

Tax is a ‘hot button’ issue across the world, and increasingly in Asia. No one is feeling this scrutiny more than financial institutions. Aside from their reporting burden arising from international initiatives such as CRS (the Common Reporting Standard) and FATCA (the Foreign Account Tax Compliance Act), they are also being called on to help their HNWI (high net-worth individual) account holders meet additional tax reporting obligations from governments across the region intent on cracking down on decades of tax evasion.

Before this increased scrutiny by tax authorities, HNWIs tended to only report their onshore, not offshore, holdings or accounts. However, in the aftermath of CRS and FATCA, which oblige financial institutions and regulators to share taxpayer data across borders, and the imposition of penalties in some countries for not declaring offshore assets, they can no longer sustain this approach.

“Currently, due to reporting requirements under CRS and other information sharing arrangements, banks are obliged to report clients’ assets to regulators,” explains Marco Kundert, Head of Tax Products Asia at BearingPoint Singapore. “As a result, clients need to do their tax filings diligently and they will turn to banks to provide them with the additional information required regarding their taxable base.”

10%

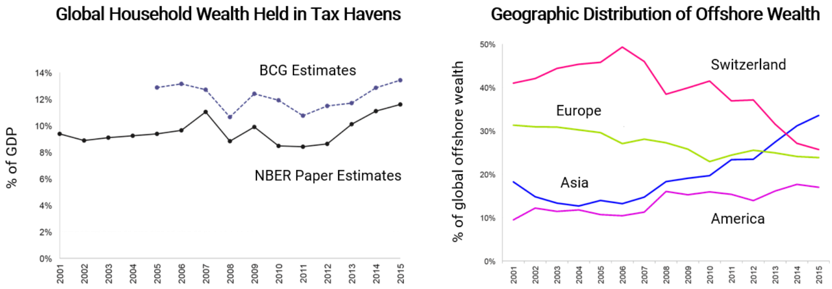
World’s GDP held in offshore wealth centres

Before we look at what financial institutions could do to help clients address the rise in demand for more and better tax reporting, and how they might do that, it is worth looking at estimates of the amount of wealth held offshore and what governments, particularly in Asia, have been doing to uncover it.

A recent paper from the NBER (National Bureau of Economic Research) in the US estimated that the equivalent of 10% of the world’s GDP is held in offshore wealth centres[1]. Few of these locations ever disclosed data on the amount of global wealth they held until 2016, when many authorised the BIS (Bank for International Settlements) to make these statistics publicly available. Though attempts were made to account for missing data, the NBER estimate may still be conservative, as some offshores centres including Panama and Singapore still do not disclose their statistics, and the BIS data only covered bank deposits, not the portfolios of equities, bonds, and mutual funds in which most offshore wealth is held. The use of anonymous shell corporations also makes it hard to identify the beneficial owners of wealth held offshore.

Switzerland remains the largest offshore wealth centre, with a share of 24%, having first developed cross-border wealth management as early as the 1920s. However, Hong Kong and Singapore are now the fastest growing offshore wealth centres due to their status as preferred booking centres for regional clients, according to BCG's Global Wealth Report 2017[2]. The Asia Pacific region is indeed the fastest growing source of offshore wealth, with a compound annual growth rate of 6%.

Asia Pacific to Post Highest Growth in Offshore Wealth Through 2021

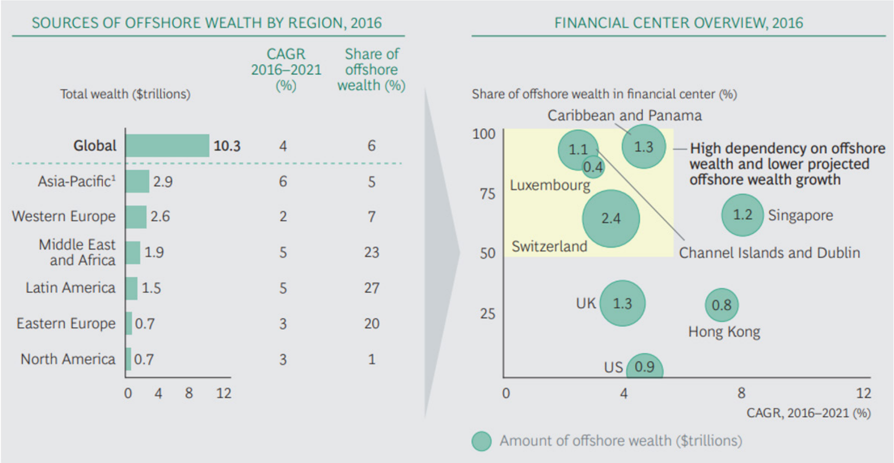


Note: Global amount of wealth owned by households in all the world's tax havens at the end of each year, as a fraction of world GDP.

Note: Share of global offshore wealth managed in Switzerland, in the other European offshore centres (Cyprus, Guernsey, Jersey, Isle of Man, Luxembourg, Austria, Belgium, UK), in the Asian offshore centres (Hong Kong, Singapore, Macao, Malaysia, Bahrain, Bahamas, Bermuda, Netherland Antilles), and in the American offshore centres (Cayman Islands, Panama, US).

Source: "Who Owns the Wealth in Tax Havens? Macro Evidence and Implications for Global Inequality", Journal of Public Economics, Sep 2017

Where is the World's Offshore Wealth?


SOURCES OF OFFSHORE WEALTH BY REGION, 2016

	Total wealth ($trillions)	CAGR 2016–2021 (%)	Share of offshore wealth (%)
Global	10.3	4	6
Asia-Pacific[1]	2.9	6	5
Western Europe	2.6	2	7
Middle East and Africa	1.9	5	23
Latin America	1.5	5	27
Eastern Europe	0.7	3	20
North America	0.7	3	1

Source: Source: BCG Global Wealth Report 2017

The NBER paper suggests institutions facilitating tax evasion should face harsher penalties that go beyond fines, which are seen as a cost of doing business and are small compared with profits, such as threats to withdraw banking licences. This, the paper says, would serve as a stronger deterrent and force tax havens to be more transparent.

A new era of transparency

CRS was developed by the OECD (Organisation for Economic Cooperation and Development) as a standard for exchanging financial and tax information between jurisdictions globally, an idea similar to FATCA agreements which require foreign financial institutions to report on their US account holders. Taking the lead from EU member states and others, more than 12 Asia Pacific countries have signed up for AEOI (Automatic Exchange of Information) under CRS to combat cross-border tax evasion by facilitating data sharing between jurisdictions.

For instance, among more than 50 AEOI relationships worldwide, Singapore has agreed to share information with Australia, Hong Kong, China, Japan, Indonesia, Malaysia, South Korea, Indonesia, India and Pakistan[3]. Hong Kong itself has AEOI agreements in place with more than 70 jurisdictions[4].

Indonesia's Tax Amnesty

$360Bn

Declared Assets

However, the time it has taken to get CRS going has helped people intent on revealing little or nothing about what they have offshore: "Certain gaps in the current CRS regime give people time to reshuffle their holdings and structures," said the head of tax at a Hong Kong private bank. "There is still room for manoeuvre due to different start dates for exchange of information between different countries and the different degrees of sophistication of tax authorities in different countries." As a result, tax authorities in different countries are adopting different approaches to tackling tax evasion and collect tax money more quickly, she added.

Some jurisdictions are incentivising tax declarations by offering tax amnesties, which allow those who have evaded tax for years to declare unreported income and assets with no, or lesser, criminal or civil penalties than would have been the case if they had not availed of the amnesty.

Indonesia's 2016-2017 tax amnesty scheme saw over 900,000 taxpayers declare more than USD360 billion in assets. This achieved 120% of the government's target and was thus considered a success from an asset declaration standpoint[5]. However, the amnesty fell short of the government's target for undeclared assets held offshore. Only a quarter of the newly declared assets were located outside Indonesia, representing about 36% of the USD250 billion that was initially estimated to be held overseas[6]. Of only USD11 billion repatriated (just 15% of the repatriation target), Singapore and Hong Kong accounted for 57% and 11%, respectively.

India has historically implemented multiple tax amnesty schemes over the years, the latest in 2016 which allowed citizens four months to report previously undeclared assets without risk of prosecution. The amnesty resulted in over 60,000 declarations of hidden assets worth USD9.8 billion. But this was considered a drop in the bucket for India, a country of 1.3 billion people where only 37 million individuals filed tax returns in 2017[7].

Pakistan also announced a tax amnesty scheme of its own, set to run until 30 June 2018, allowing its nationals to declare assets with a one-off maximum penalty of 2% if they are offshore and 5% if onshore[8].

The Philippines is looking to follow suit, having filed a Senate bill in June 2017 that seeks to introduce an amnesty on income and estate taxes by the end of 2018[9]. A second bill, if passed, will additionally repeal the country's banking secrecy law, which to date has prohibited banks from providing personal and account information about customers to authorities except in criminal matters[10]. Passage of both bills will pave the way for the Philippines to join AEOI and motivate citizens to participate in the amnesty offer, said the Joint-Foreign Chambers[11].

Meanwhile, Australia recently announced that of the 578 Australians identified in March 2017 as having links to Swiss bank accounts, over 80% have now complied with their tax obligations[12]. The ATO (Australian Taxation Office) is working with law enforcement agencies to take immediate action against the remaining 106 taxpayers, who it says have conducted 5,000 cross-border transactions worth over USD670 million in the past 10 years. According to the government, increasingly regular information releases from a range of sources is being cross-matched against existing intelligence, making it more difficult for taxpayers to hide income and assets offshore.

If amnesties, along with voluntary disclosure programmes, another device favoured by national tax authorities, failed to convince HNWIs that it was increasingly difficult to hide their wealth, the release of the Panama Papers in 2016 and its follow-up, the Paradise Papers a year later, both highly-publicised investigations into the offshore industry by journalists based around the world, should have been the final confirmation. But beyond having to meet domestic and international requirements on tax reporting, HNWIs also know they need to be transparent to avoid reputational damage[13].

Trends in Europe

Reputational damage is a key consideration in Germany, where states and the tax authorities have publicly exposed tax evaders in newspapers, further warning that more data in their possession could expose others trying to game the tax system. The fines for non-compliance were not high, but the motivation to avoid the threat of reputational damage was enough for many people to decide to reveal their assets.

"Calculation of capital gains from investments could definitely be a differentiator for private banks and wealth managers if they can provide such a service to clients"

In the EU – an object lesson in how HNWIs in Asia will come to face greater tax scrutiny – finance ministers agreed in March 2018 on new measures to force accountants, lawyers, tax advisers and banks to report aggressive tax avoidance schemes. Member states will start to exchange this information with each other every three months through a centralised database, beginning on 31 October 2020[14].

Due to this and other regional and international initiatives, European financial institutions have sought ways to expand how they deliver tax information to make their clients' tax reporting easier. BearingPoint has seen demand for client tax reporting information in Europe soar to more than 90% of the HNWI segment over the past five years.

Demand in Asia

Like in Europe, as the demand for client tax reporting in Asia continues to rise, support services aimed at helping clients meet their reporting obligations will become a key differentiator and source of revenue for wealth managers and private banks in the region.

"Calculation of capital gains from investments could definitely be a differentiator for private banks and wealth managers if they can provide such a service to clients," said an Asian-based private bank. "There is demand in the market for this, particularly with client's diversifying their investments across asset classes and regions with varying capital gains tax implications."

More agreements in Asia to exchange information across jurisdictions, coupled with growing pressure on clients to be tax transparent in their home countries, will increase the need for financial institutions to help clients produce information about what they need to report, including income from interest and dividends and capital gains on wealth. It is important to note here that this is not tax advisory – banks tend to avoid advising their clients on how best to reduce tax liabilities.

In the coming years, financial institutions can expect to have to comply with more requirements from governments and regulators for tax information. It could mean extending existing client relationships to include tax information and related calculations to maintain a competitive advantage. At the same time, meeting the long-term implications of cross-border tax reporting requirements, will be particularly challenging for financial institutions operating in multiple jurisdictions.

The levels of reporting required vary around the world, with different jurisdictions displaying different levels of sophistication. "Australia is a very mature market, with a very sophisticated onshore system which always placed importance on tax reporting," says BearingPoint's Kundert. "Similarly, in post-financial crisis Europe, the demand for reporting of tax information has been increasing strongly. In South East Asian countries like Indonesia, clients are about to start become more demanding as they face mounting pressure to declare taxes accurately."

Tax declaration pressures mount

Banks are being asked to share information about account holdings going back eight to 10 years

The revised India-Singapore double taxation avoidance agreement , including exchange of information provisions, came into effect last year. Since then, the Inland Revenue Authority of Singapore has been seeking details of Indian-owned accounts to establish beneficial ownership and report this information to the tax authorities in India. Account holders could face prosecution for assets that have not been declared to India authorities under a foreign black money law passed in 2015. Banks are being asked to share information about account holdings going back eight to 10 years, including details about taxpayers who may no longer have a bank account outside India[15].

Pressure is also mounting elsewhere in Asia. Chinese HNWIs hold almost USD3 trillion offshore, mostly in Hong Kong but with an increasing preference for Singapore, where account holders are not visible to the Chinese government[16]. The number of Chinese HNWIs who prefer Hong Kong is down to 53% from 71% two years ago, due to tax agreements that require the city's financial institutions to report client information to tax officials, which may then be exchanged with China for its crackdown on tax cheats. Last year it was announced that all accounts at Chinese deposit-taking institutions, policy banks, investment agencies and insurers must have detailed information for tax assessments, including names, addresses, account balances and revenue flows[17].

Meanwhile in Japan, regional tax bureaus nationwide have established project teams tasked with gathering information on the wealthy and increased the number of officials designated to this task. The regional bureaus conducted over 4,000 income tax inspections on the wealthy in fiscal 2016, revealing about JPY44.1 billion (USD400 million) in undeclared income and penalising taxpayers an average of JPY3.04 million (USD27,800) per case.

Tax evasion is an ‘anti-social crime that must be rooted out’

South Korean financial regulators have also recently announced new measures intended to ferret out the concealment of wealth abroad. Against a background of wealthy individuals and businesses trying to hide their wealth using borrowed name accounts at home or overseas, President Moon Jae-in said tax evasion is an ‘anti-social crime that must be rooted out’. He urged financial watchdogs, tax and customs offices and law enforcement agencies to work together on the issue and to use measures such as stiff fines and criminal prosecution as penalties for tax evasion[18].

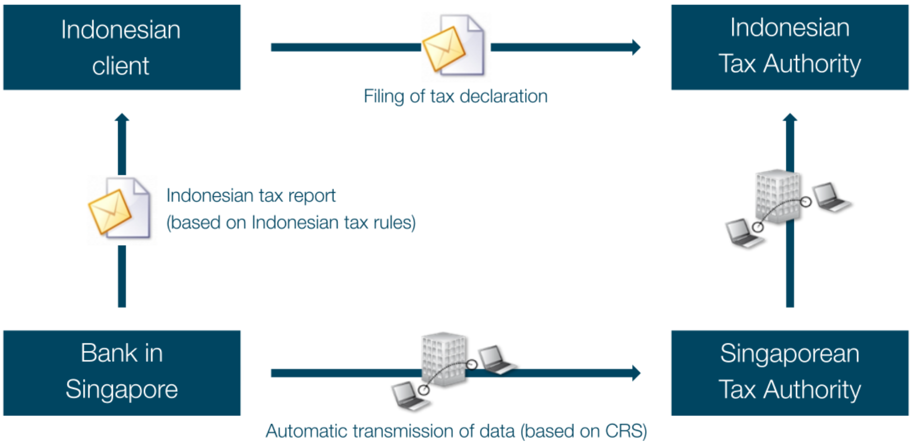
Easing client reporting obligations

The new obligations for banks to report taxpayer information present them with particular challenges. One of the most acute is that in some jurisdictions they might have not historically collected the kind of information that tax authorities want from taxpayers today. And even if they have been collecting this information, it can be difficult to extract it given it is often housed in one or more legacy systems. Indonesia, for example, requires data for at least the preceding 10 years prior to reporting, which BearingPoint’s Kundert suggests is bound to be across at least two systems and could additionally present data quality issues.

“It starts with KYC [know your customer],” said a tax expert at a multinational private bank. To be compliant, banks get basic information from the client, making sure to ask the client what tax residency they have. But other than this, “the banks don’t really go and investigate” unless there is some doubt prompting them to consult with tax advisory or legal teams. “The whole ecosystem is going to need more information.”

“Clients’ own tax calculations require multiple data points that include not just investment related information (cost of investment and sale proceeds) but also documentation on the specific requirements given their tax residency,” said a specialist at another private bank. “Many banks do not invest enough in infrastructure to produce information for the client’s own tax reporting as this is not a core banking service.”

How Client Tax Reporting Works


Indonesian client
Filing of tax declaration
Indonesian Tax Authority
Indonesian tax report
(based on Indonesian tax rules)
Bank in Singapore
Automatic transmission of data (based on CRS)
Singaporean Tax Authority

In recent years, BearingPoint has noticed a stark increase in the demand for Asia-specific reporting modules for tax reporting, indicating that financial institutions are starting to find it necessary – as is the case in the EU – to provide information for client tax reporting as part of their banking service. BearingPoint responded to this need last year by extending an offshore version for Indonesia, which enables banks to produce Indonesia-specific tax reports and provide clients from the country with details on local tax filing requirements.

EasyTax is BearingPoint's standard software solution for country-specific tax reports, enabling financial institutions to provide an additional service to ease clients' tax filing duties. Based on the applicable law, EasyTax enables the production of a tax report showing the taxable income base for the client, having applied all income, wealth and capital gain taxation rules on the client's transactions and assets held offshore. EasyTax also enables financial institutions to provide the necessary tax calculation, withholding (if any) and reporting functionalities for onshore booked clients.

In use at over 80 financial institutions worldwide, including private banks and wealth managers, EasyTax includes generic tax reporting modules for different capital gains compensation logics as an extension to cover non-country specific tax reporting requirements. In doing so, international clients can access the information they need for their tax statements, including full transaction histories for all active holdings, in any language or currency.

What’s Next?

Can a real time tax calculation engine lead to more informed investment decisions?

“In addition to calculating capital gains and losses for tax reporting purposes, we are taking tax calculation one step further in moving to real time calculation of tax impacts, which will allow banks to advise clients on a ‘performance after tax’ view” says Ronald Frey, partner at BearingPoint.

“Let’s say a client has several equities which performed very well, while others are loss-making. The ability to calculate real-time capital gains and losses, after tax, effectively allows banks to advise clients on investment decisions which optimise the taxable ‘net capital gain’ during a period. Moreover, in some countries one is not allowed to bring accumulated capital losses forward into the new tax year, so your client would be well advised to make use of these losses by off-setting capital gains on other transactions” says Frey.

Such a solution that automatically calculates after-tax investment performance in real time can be offered by banks alongside portfolio management services. And banks themselves agree that helping clients manage their tax obligations in this way can form a competitive advantage that goes beyond the original raison d’être of a tax reporting solution.

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About EasyTax

Initiatives such as AEOI (Automatic Exchange of Information) under CRS (the Common Reporting Standard) are increasing regulatory reporting requirements in the Asia Pacific region and intensifying the demand for high-quality reporting and APAC-specific tax modules. The success of EasyTax in Europe is evident by its implementation at over 80 financial institutions in multiple countries. With Australian and Indonesian modules already in use at several banks, BearingPoint adds a further keystone to its growing tax solution offering for the APAC region. The EasyTax software covers more than 20 individual jurisdictions in Europe, and, besides Australia, BearingPoint has plans to create modules for China, Hong Kong, India, Japan, Malaysia, Singapore and New Zealand. With offices in Singapore and China, BearingPoint is well positioned to serve its existing clients locally as well as to gain local market insights for new global clients in the region.

About BearingPoint RegTech

With its RegTech product unit, BearingPoint is a leading international provider of innovative regulatory and risk technology solutions (RegTech and RiskTech) and services along the regulatory value chain for financial services. Customers representing 6,000 firms worldwide, among them some of the largest international and European banks and insurance companies, as well as supervisory authorities and central banks, trust BearingPoint's RegTech products and services. BearingPoint works closely with regulators and, as a member of standardisation bodies such as the XBRL consortium, actively contributes to the standard-setting process.

BearingPoint RegTech solutions:

- Abacus Solution Suite: Regulatory management, analytics and reporting
- FiRE: Regulatory reporting for Switzerland, Liechtenstein and Bahamas
- FiTAX: Tax authorities reporting for QI/EUSD/FATCA/UK-FATCA and CRS
- EasyTax: Country specific client tax reporting

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Regulation Asia

About Regulation Asia

Since the global financial crisis, financial regulation has become increasingly complex and fragmented across jurisdictions. Regulation Asia launched in November 2013, seeking to inform and analyse the impact of financial regulations on the Asia Pacific financial services industry.

Through news, feature articles, interviews, research and events, Regulation Asia's audience and subscription base has grown to include key regulatory bodies, financial services firms and service providers.

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