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A Year in Review: The Far Reach of the IRS in Canada – *Foreign Account Tax Compliance Act*

What is FATCA?

The *Foreign Account Tax Compliance Act*¹ (“**FATCA**”) was enacted by the United States Congress in order to deal with non-compliance by US taxpayers using foreign bank accounts. FATCA requires foreign financial institutions to report to the IRS about financial accounts held by US taxpayers or by foreign entities in which US taxpayers hold a substantial ownership interest.² Therefore, among those who are affected by this legislation include: dual Canada-US citizens, US residents and citizens who are residents or citizens of Canada, US green card holders, an estate of a decedent that is a citizen, residents of the US³, and Canadians who have a joint bank account with a US person.⁴

In February 2014, the Government of Canada and the Government of the United States entered into an intergovernmental agreement (“**IGA**”).⁵ The IGA allows Canadian financial institutions to report US taxpayers’ information to the Canada Revenue Agency to be transmitted to the IRS (as opposed to directly reporting the information to the IRS). It also requires Canadian financial institutions to undertake certain due diligence procedures to identify US taxpayers’ accounts.

FATCA is not limited in its scope to the financial services industry and many Canadian entities need to be concerned about its application. Under the IGA, an entity is a financial institution if it is: (i) a depository institution⁶; (ii) a custodial institution⁷; (iii) an investment entity; or (iv) a specified insurance company.⁸

¹ *Foreign Account Tax Compliance Act*, 124 Stat 97-117 (US Congress).

² “Foreign Account Tax Compliance Act (FACTA)” (accessed: January 14, 2015), US Department of Treasury Resource Centre, online: <www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx>.

³ IGA, *infra* note 5 at para. 3(ee) definition of US Person.

⁴ Raphaëlle Deraspe & Adriane Yong, “The Canada-US Intergovernmental Agreement: Sharing Financial Information” (accessed: October 20, 2014), Economics, Resources and International Affairs Division, Library of Parliament Research Publications, online: <www.parl.gc.ca/content/LOP/researchpublications/2014-24-e.htm> [Deraspe].

⁵ *Canada-United States Enhanced Tax Information Exchange Agreement Implementation Act*, SC 2014, c 20, s 99, Schedule [IGA].

⁶ Examples of depository institutions includes, but are not limited to entities regulated in Canada as a bank, a trust and loan company, a credit society, a savings and credit union, or a caisse populaire. See Guidance, *infra* note 8 at para. 3.4.

⁷ Examples of custodial institutions include, but are not limited to: investment dealers, brokerages, and trust companies. See Guidance, *infra* note 8 at para. 3.8.

⁸ Canada Revenue Agency, “Guidance on enhanced financial accounts information reporting: Part XVIII of the Income Tax Act” (accessed: October 27, 2014), para. 3.2, online: <www.cra-arc.gc.ca/tx/nnrstdnts/nhncdrprtng/gdnc-eng.html> [Guidance]. It is important to note that the IGA includes a more restricted definition of financial institutions than the US law.

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Canadian financial institutions⁹ do not have to report on the following accounts:

1. Registered Retirement Savings Plans;
2. Registered Disability Savings Plans;
3. Registered Pension Plans;
4. Registered Retirement Income Funds;
5. Pooled Registered Pension Plans;
6. Registered Education Savings Plans;
7. Deferred Profit-Sharing Plans;
8. Tax-free savings accounts;
9. AgrilInvest Accounts; and
10. Escrow Accounts.¹⁰

In addition, pre-existing accounts that do not exceed a value of \$50,000 are not required to be reported.¹¹

Legislation to implement the IGA came into force on June 27, 2014.¹² Financial institutions that are not governed by an intergovernmental agreement are required by FATCA to register with and report directly to the IRS. Failure to register and report to the IRS subjects the financial institution to a 30% withholding tax on payments received from a US source. Under the IGA, Canadian financial institutions avoid the 30% withholding tax if they register with the IRS and report to the CRA.¹³

FATCA's Impact on Canadian Financial Institutions

(1) Requirements of FATCA for Canadian Financial Institutions

On July 1, 2014, Canadian financial institutions were required to undertake the due diligence procedures agreed to in the IGA, which identifies US taxpayers' accounts. The CRA introduced *Guidance on enhanced financial accounts information reporting* for financial institutions to assist with, among other things, the due diligence procedures and reporting obligations.¹⁴ Canadian financial institutions are required to collect and report the following information:

- the name and identifying number of the reporting Canadian financial institution;
- the name, address, and US taxpayer identification number of each account holder who is a US person (as defined in the IGA);
- the account number; and
- the account balance or value as of the end of the reporting period (or the date an account was closed).¹⁵

(2) Requirements of Canadian Financial Institutions Going Forward

By May 2nd of each year beginning in 2015, Canadian financial institutions are required to file electronically with the CRA an information return in relation to each US taxpayer's account.¹⁶ Also in 2015, Canadian financial institutions will need to collect and report the following information in addition to the information above:

- where the account is a custodial account, the total gross amount of interest, dividends, and other income generated with respect to the assets held in the account, that was paid or credited to the account during the reporting period;
- where the account is a depository account, the total gross amount of interest paid or credited to the account during the reporting period; and

⁹ There are various financial institutions that are considered non-reporting financial institutions. For example, small deposit-taking institutions with assets of less than \$175 million are exempt as well as institutions with only a local client base. See Department of Finance, "Background: Intergovernmental Agreement for the Enhanced Exchange of Tax Information under the Canada-US Tax Convention" (accessed: October 20, 2014), online: <www.fin.gc.ca/n14/data/14-018_1-eng.asp>.

¹⁰ IGA, *supra* note 5, Annex II, Part IV, Accounts excluded from definition of Financial Accounts.

¹¹ IGA, *supra* note 5, Annex I, Part II(A)(1).

¹² *Canada-United States Enhanced Tax Information Exchange Agreement Implementation Act*, SC 2014, c 20, s 99.

¹³ Barbara Shecter, "Canadian industry claims win in long fight over US crackdown on tax evasion" (accessed: October 20, 2014), *National Post*, online: <<http://business.financialpost.com/2014/06/24/education-and-retirement-savings-vehicles-safe-from-u-s-crackdown-on-tax-evasion-iiac/>>.

¹⁴ *Guidance*, *supra* note 8.

¹⁵ IGA, *supra* note 5 at Article 2, para. 2(a)(1-4), and Article 3, para. 3(a)(1).

¹⁶ Deraspe, *supra* note 4.

- where the account is not a custodial or a depository account, the total gross amount paid or credited to the account holder with respect to the account during the reporting period.¹⁷

In 2016 and subsequent years, in addition to the information required to be reported in 2015, for custodial accounts it will be necessary to report the total gross proceeds from the sale or redemption of property paid or credited to the account during the reporting period where the Canadian financial institution acted as a custodian, broker, nominee, or otherwise as agent for the US person who is the account holder.¹⁸

Each reporting Canadian financial institution will be treated as compliant with FATCA, receive a Global Intermediary Identification Number (“**GIIN**”) and therefore be exempt from the 30% withholding tax on payments received from a US source if in addition to fulfilling the collecting and reporting obligations identified above they:

1. report annually to the CRA the name of each Nonparticipating Financial Institution (as defined in the IGA) to which payments have been made and the aggregate amount of such payments;
2. register on the IRS FATCA website;
3. withhold 30% of any US Source Withholdable Payment (as defined in the IGA) to any Nonparticipating Financial Institution; and
4. provide to any immediate payor of such US Source Withholdable Payment the information required for withholding and reporting to occur with respect to such payment.¹⁹

Therefore, in order to ensure compliance, Canadian financial institutions should, among other things:

1. identify their classification under FATCA to determine whether registration is required and which collection and reporting obligations they are required to perform;
2. register with the IRS;
3. establish procedures for all new accounts to determine the US status of new clients and implementing a due-diligence process on their pre-existing accounts to determine which of their current clients are US persons; and
4. establish reporting procedures to the CRA for the information collected about their US account holders.

In order to facilitate compliance, on or about January 12, 2015, the IRS launched a secure web application for host country tax authorities (such as the CRA) to transmit and exchange FATCA data.²⁰

FATCA's Impact on US Persons Who Hold Financial Accounts in Canada

The IGA is a tax information sharing agreement only; it does not change the US tax obligations of US persons. The CRA will not assist in the collection of penalties associated with the failure of a US person to report their assets held at non-US financial institutions. Moreover, the CRA will not collect tax liabilities of a Canadian citizen if the individual was a Canadian citizen at the time the particular liability arose (even if he was also a US citizen at the time).²¹ However, armed with the knowledge the CRA provides, the IRS is better equipped to know who to pursue for tax evasion.

Canadian financial institutions now have to verify whether an account holder is a US person. As a result, individuals may be asked to certify or clarify to their financial institutions their US tax status and/or produce documents such as a driver's license for any representation they make.²²

¹⁷ IGA, *supra* note 5 at Article 2 paras. 2(a)(5)(A) and (6-7), and at Article 3 para. 3(a)(2).

¹⁸ *Ibid* at Article 2 para. 2(a)(5)(B), and at Article 3 para. 3(a)(3).

¹⁹ *Ibid* at Article 4 para. 1. Note that a Canadian financial institution that is not compliant with the conditions in paragraph 1 shall not be subject to the 30% withholding unless such reporting Canadian financial institution is treated by the IRS as a Nonparticipating Financial Institution pursuant to subparagraph 2(b) of Article 5 of the IGA.

²⁰ Internal Revenue Service, “International Data Exchange Service” (accessed: January 15, 2015), online: <<http://www.irs.gov/Businesses/Corporations/International-Data-Exchange-Service>>.

²¹ BDO, “Tax Alert – Canada Announces Intergovernmental Agreement with the United States over FATCA” (accessed: October 27, 2014), online: <www.bdo.ca/en/Library/Services/Tax/pages/Tax-Alert-Canada-Announces-Intergovernmental-Agreement-with-the-United-States-over-FATCA.aspx>.

²² Canadian Revenue Agency, “Information for individuals with accounts with Canadian financial institutions” (accessed: January 14, 2015), online: <www.cra-arc.gc.ca/tx/nnrsdnts/nhncdrprtng/ndvdl-eng.html>.

A Canadian financial institution that maintains an account identified as belonging to a US person has to report that person's US federal taxpayer identification number (which is usually their US social security number) when reporting information to the CRA. US persons are required to provide their US federal taxpayer identification number to their financial institution when asked for it. Failure to provide their identification number may cause the CRA to exchange information about their account with the IRS prior to confirming their US tax status.²³

Before FATCA, the IRS was likely unaware of certain transactions that occurred outside the US which should have attracted US tax consequences. The IGA assists the IRS in determining who has failed to pay US taxes on these type of transactions. To avoid unintended consequences, if you have financial accounts in Canada and have not already reported all of your worldwide financial assets to the IRS, you should:

1. determine your US tax status (are you a US person under the IGA?); and
2. if you are a US person, consult a US tax lawyer.²⁴

Since 2009, the IRS has collected US\$6.5 billion in unpaid tax and penalties and approximately 45,000 Americans have disclosed offshore holdings.²⁵

The Canadian Initiative

FATCA appears to have influenced the Canadian government to implement its own initiative aimed at identifying tax evasion and aggressive tax avoidance. Effective January 1, 2015, the CRA's electronic funds transfer rules came into force requiring certain financial intermediaries to report incoming and outgoing transfers of CAD\$10,000 or more to the CRA. The rules require that a qualifying electronic funds transfer be reported within five business days of the transaction. For this purpose, multiple transactions occurring within a 24-hour period conducted by, or on behalf of, a single entity will be aggregated to determine if the transfer is CAD\$10,000 or more. This new requirement applies to financial intermediaries defined in the *Income Tax Act*²⁶ as "reporting entities" including: banks, credit unions, caisses populaires, trust and loan companies, money service businesses and casinos.²⁷ If Canada's response to FATCA is any indication of the tone in Canada, the era of transparency, enhanced regulation and strong sanctions for offshore financial management is here to stay.

²³ *Ibid.*

²⁴ If you are a US person, the tax lawyer may advise you to enroll in the IRS's Offshore Voluntary Disclosure Program (which may close at any time). The Voluntary Disclosure Program allows taxpayers with undisclosed income from offshore accounts an opportunity to be current with their tax returns. Internal Revenue Service, "2012 Offshore Voluntary Disclosure Program" (accessed: January 14, 2015), online: <www.irs.gov/uac/2012-Offshore-Voluntary-Disclosure-Program>.

²⁵ Internal Revenue Service, "IRS Offshore Voluntary Disclosure Efforts Produce \$6.5 Billion; 45,000 Taxpayers Participate" (accessed: January 14, 2015), online: <[www.irs.gov/uac/Newsroom/IRS-Offshore-Voluntary-Disclosure-Efforts-Produce-\\$6.5-Billion-45,000-Taxpayers-Participate](http://www.irs.gov/uac/Newsroom/IRS-Offshore-Voluntary-Disclosure-Efforts-Produce-$6.5-Billion-45,000-Taxpayers-Participate)>.

²⁶ *Income Tax Act*, RSC 1985, c 1 (5th Supp).

²⁷ Canada Revenue Agency, "Electronic Funds Transfer Reporting" (accessed on January 13, 2015), online: <www.cra-arc.gc.ca/eft/>.

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