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The Future of Foreign Account Tax Compliance Act (FATCA) in Canada: Pros and Cons of the Intergovernmental Agreement (IGA)

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The **U.S. Foreign Account Tax Compliance Act**, more commonly known as FATCA, was passed in 2010. FATCA requires foreign financial institutions ("FI"s) to report on the account information of U.S. citizens and residents (including dual citizens) to the **IRS** starting in July 2014.

Although the requirement to report directly to the IRS violated **Canadian privacy laws**, there were withholding tax consequences for non-compliance with FATCA. The uproar in Canada over the privacy issue and the financial costs of implementing FATCA led to the signing of an intergovernmental agreement ["IGA"] between Canada and the U.S. on February 5, 2014.

Draft legislation required to implement the **IGA** in Canada was proposed by the Canadian Department of Finance on the same date. The deadline for comments was March 10, 2014, and the legislation is currently being reviewed with all comments in mind. This process has not only initiated discussion of Canada's draft legislation, but it has renewed the debate over the benefits – or lack thereof – of the IGA.

One major issue with Canada's draft legislation is its definition of "FI", which is narrower than the definition of FI in the IGA, Treasury Regulations and IGAs signed by the U.S. and foreign countries other than Canada.

If certain entities, such as private trust and holding companies, are not considered FIs in Canada but are considered FIs elsewhere, the confusion could result in penalties for Canada. The U.S. might consider Canada's implementation of the IGA invalid because of its use of rogue legislation, subjecting Canadian FIs to FATCA as if the IGA had never been signed at all.

If the U.S. does accept the legislation as a valid implementation of the IGA in Canada, the entities classified as FIs by the U.S. but not Canada might be singled out and charged withholding penalties. These entities would then have to deal directly with the IRS.

Canada's proposed legislation creates legislative uncertainty and unnecessarily complicates compliance with an already onerous, costly piece of legislation.

If implemented properly, however, the merits of the IGA between Canada and the U.S. are plentiful. Under the IGA:

- Instead of FIs violating Canadian privacy laws by reporting directly to the IRS, they will report to the CRA, who will, in turn, pass the relevant information on to the IRS.
- Generally, accounts under $50,000 do not need to be vetted by Canadian FIs to determine whether they are held by U.S. clients.
- Registered accounts like RRSPs and TFSAs do not need to be reported by Canadian FIs.
- The 30% withholding tax penalty will not apply to clients of Canadian FIs, and will only apply to Canadian FIs in severe violation of FATCA.
- FIs with assets of less than $175 million, such as credit unions, will be exempt from FATCA.

In general, it will cost Canadian FIs far less money to implement FATCA if they only have to report to the CRA and the above exemptions are in place.

However, the IGA does not eliminate all of FATCA's downfalls.

- Canadian FIs will still be required to collect personal information from Canadian clients who attempt to open new accounts in order to prove that such people are not American.
- The reporting requirements under the IGA are still detailed and complex and will be costly for FIs to implement.
- Most importantly, the IGA increases the effectiveness of the exchange of information between the IRS and the CRA. In exchange for the CRA's

  information, the IRS will automatically report on certain accounts held by Canadian residents in the U.S. This will cause issues for cross-border taxpayers who are non-compliant with their tax filings.

For American citizens living in Canada who have not filed income tax returns with the IRS, the IGA is significant. The information shared with the IRS by the CRA is more likely to alert the IRS to American citizens living abroad who have failed to file.

The increased exchange of information between the IRS and CRA will also mean that Canadian residents with U.S. account holdings need to be aware of their obligation to report this U.S. revenue in Canada. If they are not tax-compliant, the CRA will soon find out.

There is, however, skepticism surrounding the ability of the IRS to report on Canadian-held accounts. The IGA lacks details regarding the U.S.'s end of the information exchange bargain, and the U.S. does not need to report Canadian information to the CRA until 2017, while Canada must comply as soon as it is ready, with a target date of July 1, 2014.

Although the IGA will provide some relief from FATCA for Canadian FIs and Americans in Canada if it

is validly implemented, there are still issues to be concerned about. Please contact your team of cross-border advisors for further information regarding the IGA and FATCA.

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