Canadian FATCA and CRS Compliance Updates

December 10, 2018

It has now been almost five years since Canada entered into the Canada-United States Enhanced Tax Information Exchange Agreement (the IGA), which was implemented by the Canada-United States *Enhanced Tax Information Agreement Implementation Act* together with the addition of Part XVIII and other amendments to the *Income Tax Act* (Canada) (the Tax Act) (collectively referred to as FATCA). The introduction of FATCA has had a major impact on financial institutions and financial products around the world, and together with the implementation of the Common Reporting Standard (CRS), has ushered a new environment of tax compliance and cross-border tax authority cooperation.

In the first five years of FATCA, there has been a lot of growing pains as Canadian financial institutions embraced, sometimes reluctantly, their new responsibilities to review, identify and report financial accounts of specified U.S. persons (*i.e.*, U.S. reportable accounts). Generally, while Canadian financial institutions made their best efforts to ensure they were complying with their obligations under Part XVIII of the Tax Act, there has not been much in the way of oversight of their activities nor repercussions for failures to meet service standards in due diligence and reporting. More recently, announcements from both the Internal Revenue Service (IRS) and the Canada Revenue Agency (CRA) have indicated that the honeymoon period for FATCA compliance may be coming to an end. This paper discusses those announcements together with the most recent changes to the CRA's guidance on FATCA (*i.e.*, the Guidance on Enhanced Financial Account Information Reporting – Part XVIII of the Income Tax Act) and its parallel guidance for CRS (*i.e.*, the Guidance on the Common Reporting Standard – Part XIX of the Income Tax Act), both of which were released on July 31, 2018 (referred to herein as the CRA FATCA Guidance and the CRA CRS Guidance, respectively, and collectively as the Guidance).

Missing U.S. TINs

On September 25, 2017, the Internal Revenue Service (the IRS) issued Notice 2017-46 (the IRS Notice), that provided revised guidance related to obtaining and reporting U.S. taxpayer identification numbers (TINs) and dates of birth by foreign financial institutions (FFIs). In accordance with the IRS Notice, provided that reporting Model 1 FFIs (including reporting Canadian FFIs) comply with the procedures described in the IRS

Notice, then the IRS will not determine that there is significant non-compliance with their obligations under their Model 1 IGA solely as a result of a failure to report U.S. TINs associated with the FFI's U.S. reportable accounts maintained as of the determination date specified in the applicable Model 1 IGA.1

As noted in the IRS Notice, each Model 1 IGA provides that a reporting Model 1 FFI shall be treated as complying with, and not subject to withholding under, section 1471 of the Internal Revenue Code if the partner jurisdiction (*e.g.*, Canada) complies with its obligations under the IGA with respect to such FFI and such FFI complies with its reporting and registration obligations in accordance with the IGA.2 Information required to be reported under the IGA includes the U.S. TIN of account holders that are U.S. specified persons and, in the case of passive non-financial foreign entities (NFFEs), the U.S. TIN of any controlling persons that are U.S. specified persons.

The IRS Notice states that the U.S. Treasury Department and the IRS understand that some reporting Model 1 FFIs need additional time to implement practices and procedures to obtain and report the required U.S. TINs. Accordingly, with respect to reporting pre-existing accounts that are U.S. reportable accounts for calendar years 2017, 2018 and 2019, the U.S.Competent Authority will not determine that there is significant non-compliance solely as a result of a failure to obtain and report a U.S. TIN, provided that the reporting Model 1 FFI:

- obtains and reports the date of birth of each account holder and controlling person whose U.S. TIN is not reported;
- requests annually from each account holder any missing required U.S. TIN; and
- before reporting information that relates to calendar year 2017 to the partner jurisdiction, searches electronically searchable data maintained by the reporting Model 1 FFI for any missing required U.S. TINs.

As noted in the IRS Notice, the U.S. Competent Authority has begun sending out notifications to Model 1 jurisdictions, including Canada, asking that missing U.S. TINs be provided. In response to such notifications, and consistent with the IRS Notice, the CRA has updated the most recent CRA FATCA Guidance to address the requirements enumerated above. In addition, the CRA FATCA Guidance states it is expected that reporting Canadian financial institutions will design/adjust their systems and procedures to meet these requirements, including reporting nine "A"s in the U.S. TIN field instead of nine "0"s for 2018 and 2019. The CRA FATCA Guidance further states that a Canadian financial institution will not be required to design/adjust its system to include nine "A"s in the U.S. TIN for the 2017 calendar year and is not required to advise the CRA on whether it has performed all of the new requirements. However, it is required to keep a record of its procedures.

Unless further extended, all missing or invalid U.S. TINs will be considered an indication of significant non-compliance by the Canadian FFI for 2020 and subsequent years. A Canadian FFI that is determined to be in significant non-compliance with its obligations under the IGA and Part XVIII of the Tax Act will be reported to the CRA by the IRS, as the IRS is entitled to notify the CRA of significant non-compliance by an FFI pursuant to the terms of the IGA. If contacted, the CRA's policy is to first attempt to resolve the matter. If voluntary compliance and/or administrative action by the CRA fail to resolve the issue within 18 months of the IRS's notification, the IRS is entitled to treat the FFI as an non-participating FFI and trigger the adverse consequences associated with that

status in the U.S., which includes a 30 per cent USD withholding tax on U.S. source income and gross proceeds imposed under FATCA.

Recent CRA Technical Interpretation

In addition to the most recent updates to the Guidance (discussed in greater detail below), the CRA has also recently issued a technical interpretation relating to FATCA.3 The CRA was asked whether a new individual depositary account that exceeds US$50,000 threshold provided for in the IGA may be designated under subsection 264(1) of the Tax Act in a subsequent year if the depositary account balance drops below the US$50,000 threshold at the end of that subsequent year. The CRA confirmed that once the US$50,000 threshold is exceeded at the end of any given year, it remains reportable regardless of its balance in subsequent years, and thus may no longer be designated not to be a US. reportable account pursuant to paragraph 264(1)(b) of the Tax Act. The CRA also noted that the reporting obligation for new individual depositary accounts is different than that for pre-existing individual depositary accounts. In the case of pre-existing individual depositary accounts, the US$50,000 threshold is measured yearly. As a result, where a pre-existing individual depositary account exceeds US$50,000 at the end of a calendar year, and the account balance later drops below US$50,000 at the end of a subsequent year, a reporting Canadian financial institution may designate that account to not be a U.S. reportable account pursuant to paragraph 264(1)(a) of the Tax Act for that subsequent year.

Updates to the Guidance

This past July, new versions of the CRA FATCA Guidance and the CRA CRS Guidance (collectively, the Guidance) were released by the CRA. The revisions to the Guidance included various technical clarifications, including further guidance on the treatment of partnerships and trusts and the determination of controlling persons and the treatment of deemed compliant FFIs that have a change in status.

Determination of Controlling Persons and Partnerships

The Guidance has been updated to clarify the meaning of "controlling persons" for purposes of a legal arrangement that is neither a corporation nor a trust. For such entities, controlling persons are persons in equivalent or similar positions to those described with respect to trusts (*e.g.*, beneficiaries), who directly or indirectly own or control 25 per cent or more of the legal arrangement.

Where the control is exercised through other means than ownership, the controlling persons are the persons in equivalent or similar positions to those applicable to trusts (*e.g.*, persons exercising ultimate effective control over the legal arrangement).

With respect to controlling persons of partnerships that are not Canadian financial institutions for purposes of Part XVIII and Part XIX, the Guidance now provides the following illustration:

According to the partnership agreement, Howard will invest $100,000 in the partnership to buy equipment and rent space for the entity, and Betty will be solely responsible for operating the entity and performing its business. All decisions related to the partnership

must be unanimous; in case of a disagreement, either partner can decide to end the partnership. Howard will get 85 per cent of the proceeds of sale of the business assets, while Betty will get 15 per cent.

The business structure is important in this example and control of the entity is shared between Howard and Betty despite an uneven split of proceeds in the case the business is sold. They are both considered to hold an equivalent or similar position to a settlor of the legal arrangement.4

Trust Reporting

The Guidance has also been updated to clarify that a Canadian FFI that is a trust, *i.e.*, a trust that is a "listed financial institution", as such term is defined in subsection 263(1) of the Tax Act, whose "effective management and control" takes place in Canada, will for reporting purposes, also be considered resident in Canada if one or more of its trustees is resident in Canada. The Guidance notes that when a trust is considered a Canadian financial institution with one or more trustees resident in another partner/participating jurisdiction, the trust may be required to report to the other partner/participating jurisdiction with respect to the accounts maintained in that other jurisdiction. In such cases, accounts maintained and reporting to another partner/participating jurisdiction are not required to be reported in Canada. However, the Canadian trustee will have to be prepared to demonstrate that all necessary reporting has been completed by the trust.

Financial Accounts Held by Minors

The Guidance has been updated to reflect that where a parent or legal guardian has opened a financial account on behalf of a child that is considered the account holder, the parent or legal guardian is able to complete and sign self-certifications on behalf of the child.

Updates to the CRA CRS Guidance

The CRA's recent amendments also included FATCA or CRS specific updates. In the case of the CRA CRS Guidance, the CRA clarified that consistent with frequently asked questions (FAQs) on the OECD Commentaries, the following financial accounts are now included as low risk or "excluded accounts":

- certain financial accounts held by condominium corporations or housing cooperatives; and
- a depositary account in the form of a reloadable payment card on which monthly deposits cannot exceed US$1250 and for which financial institutions are applying Anti-Money Laundering (AML)/Know Your Client (KYC) procedures.

Updates to the CRA FATCA Guidance

Changes in status

The CRA FATCA Guidance has been updated to reflect circumstances where the status of a Canadian FFI has changed as a result of the exchange of units/securities of the Canadian FFI.

The CRS FATCA Guidance now clarifies that where a Canadian FFI with limited or no reporting obligations ceases to be a deemed-compliant FFI to become a reporting Canadian FFI because it is merged into or is acquired by another FFI and/or because it no longer meets the criteria to maintain its status as a deemed-compliant FFI, the Canadian FFI need only undertake account identification procedures with respect to new accounts opened on or after the date of the merger or acquisition or when it lost its status to identify accounts held by specified U.S. persons. In the case of a Canadian FFI with limited reporting obligations prior to the change of status, the Canadian FFI is not required to review pre-existing accounts maintained prior to such time unless there is a subsequent change in circumstances associated with the account. In the case of a Canadian FFI with no reporting obligations prior to the change of status, the account identification procedures for pre-existing accounts opened before the financial institution became a reporting Canadian FFI must be carried out at the latest by December 31 following the date the financial institution became a reporting Canadian FFI or by December 31 of the year after the year the financial institution became a reporting Canadian FFI if it takes place after September 30 of any calendar year.

The CRS FATCA Guidance also clarifies that where a Canadian FFI ceases to be a deemed-compliant FFI with no reporting obligation under the IGA to become a deemed-compliant FFI with limited reporting obligations under the IGA, the Canadian FFI must undertake account identification procedures on new accounts opened on or after the date it becomes a deemed-compliant FFI with limited reporting obligations. The account identification procedures for pre-existing accounts opened before the financial institution became a deemed-compliant FFI with limited reporting obligations must be carried out at the latest by December 31 following the date the financial institution became a deemed-compliant FFI with limited reporting obligations or by December 31 of the year after the year the financial institution became a deemed-compliant FFI with limited reporting obligations if it takes place after September 30 of any calendar year.

FATCA Certifications

Finally, by way of update, it is important to note that while most Model 1 IGA FFIs (*e.g.*, Canadian FFIs) are not required to make certifications of FATCA compliance to the IRS, Model 1 IGA FFIs with branch operations in Model 2 IGA or non-IGA countries and FFIs relying on certain registered deemed-compliant statuses under the US Treasury Regulations are required to complete such certifications on the IRS FATCA registration portal. As such, Canadian FFIs should not ignore requests from the IRS in this regard and should confirm whether such certifications are required in their particular circumstances.

1 In respect of the Canadian IGA, the determination date is June 30, 2014.

2 A Reporting Canadian FFI must obtain a Global Intermediary Identification Number (GIIN) by registering on the IRS FATCA registration website. This is required even if

none of the financial accounts maintained by the Reporting Canadian FFI are U.S. reportable accounts.

3 See CRA Views 2018-0759081E5.

4 See paragraph 10.75 of the CRA FATCA Guidance. An equivalent example is provided at paragraph 10.52 of the CRA CRS Guidance.

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