Canada and the US sign intergovernmental agreement to implement FATCA

On 5 February 2014, Canadian Finance Minister Jim Flaherty announced that, after lengthy negotiations, Canada has signed an Intergovernmental Agreement (IGA) with the United States regarding the enhanced exchange of tax information in connection with the Foreign Account Tax Compliance Act (FATCA). The Department of Finance also released legislative proposals to implement the IGA under Canadian law, related explanatory notes and a selection of FAQs with responses. The legislative proposals are contained in the Canada-United States Enhanced Tax Information Exchange Agreement Implementation Act (the Tax Information Exchange Act or Legislative Proposals). Although the IGA must still be ratified in order to enter into force, its conclusion provides greater clarity to Canadian financial institutions on how FATCA will apply in Canada.

As the IGA will be implemented into Canadian domestic law, compliance will be mandatory for all Canadian financial institutions that are not otherwise exempted under the terms of the IGA or the implementing legislation. The Canada Revenue Agency (CRA) is expected to issue additional commentary in the form of Guidance Notes in due course to assist with the interpretation and implementation of the IGA. It is anticipated that the Guidance Notes will provide significant interpretations regarding the application of the IGA in Canada particularly with respect to documentation, due diligence and reporting requirements.

Key highlights of the Canadian IGA and Tax Information Exchange Act

Model 1A Agreement

The text of the Canadian IGA is largely consistent with the Model 1 IGA and accompanying Annex I and Annex II last updated 4 November 2013 by the US Department of the Treasury. Under the agreement, a Canadian entity (including a Canadian branch of an entity established outside of Canada) that is considered a financial institution as defined for these purposes will generally be required to undertake certain documentation, due diligence, withholding and information reporting obligations in respect of financial accounts it maintains under the terms of the Canadian IGA.
**Timing**
Information released by the Department of Finance indicates that the Canadian requirements under FATCA will be effective 1 July 2014 for Canadian financial institutions.

**Definition of financial institution**
The Legislative Proposals provide for a modified definition of financial institution which requires that an entity meet the definition of financial institution as defined under the Model 1 IGA as well as be subject to regulation under certain provincial or federal statutes. This modification effectively removes certain trusts and investment companies from being considered financial institutions.

**Documentation requirements**
Annex I of the Canadian IGA, which details the account-specific documentation requirements, is substantially consistent with the Model Annex I. However, the Legislative Proposals allow for broader reliance on reviews for US indicia as a method of documenting clearly identifiable groups of individual accounts than is specifically permitted under the IGA. It is anticipated that significant interpretations regarding documentation standards will be provided in the Guidance Notes.

**Withholding**
While the Quick Facts listed by the Department of Finance indicate that no withholding will be required under FATCA for Canadian financial institutions, the Canadian IGA contains a provision requiring 30% withholding when a qualified intermediary that has assumed primary withholding responsibility, withholding foreign partnership or withholding foreign trust makes a withholdable payment to a nonparticipating financial institution. It is hoped that the Guidance Notes may provide additional commentary to reconcile this difference.

**Reporting**
New Part XVIII will be added to the *Income Tax Act (Canada)* to require the information reporting specified under the Canadian IGA. The information reporting must be filed electronically with the CRA and will be provided by the CRA to the US government. The first information reporting to be filed by Canadian financial institutions will be due 2 May 2015.

**Products exempted**
The following specific products are listed in Annex II as excluded from the definition of financial account and therefore are not subject to documentation, withholding or information reporting requirements:
- Registered retirement savings plans (RRSPs)
- Registered retirement income funds (RRIFs)
- Pooled registered pension plans (PRPPs)
- Registered pension plans (RPPs)
- Tax-free savings accounts (TFSAs)
- Registered disability savings plans (RDSPs)
- Registered education savings plans (RESPs)
- Deferred profit sharing plans (DPSPs)
- AgriInvest accounts
- Eligible funeral arrangements
- Certain escrow accounts

**Penalties**
Various existing provisions of the *Income Tax Act (Canada)* dealing with failures to file or make a return as required and failure to provide a social insurance number or business number upon request will be amended to include failures under the new reporting requirements of the Canadian IGA. In addition, failure to comply with the new record-keeping requirements will be considered an offense under the *Income Tax Act (Canada)*. A general anti-avoidance provision will also be added for persons that enter in arrangements or engage in practices with the primary purpose of avoiding any part of these requirements.

**Record retention**
The Legislative Proposals set a general retention period of at least six years following the end of the last calendar year in respect of which the record is relevant (or, for self-certifications, six years from the last day on which a related financial account is open).

Select detailed discussion

**Definition of financial institution**
Under the Legislative Proposals, the definition of financial institution has been modified to be an entity that meets the definition of financial institution as defined under the Model 1 IGA and that is
subject to regulation under certain provincial or federal statutes. Specifically, a Financial Institution means any entity that is a custodial institution, a depository institution, an investment entity or a specified insurance company and that is:

- An authorized foreign bank within the meaning of section 2 of the Bank Act in respect of its business in Canada, or a bank to which that Act applies;
- A cooperative credit society, a savings and credit union or a caisse populaire regulated by a provincial Act;
- An association regulated by the Cooperative Credit Associations Act;
- A central cooperative credit society, as defined in section 2 of the Cooperative Credit Associations Act, or a credit union central or a federation of credit unions or caisses populaires that is regulated by a provincial Act other than one enacted by the legislature of Quebec;
- A financial services cooperative regulated by An Act respecting financial services cooperatives, R.S.Q., c. C-67.3, or An Act respecting the Mouvement Desjardins, S.Q. 2000, c. 77;
- A life company or a foreign life company to which the Insurance Companies Act applies or a life insurance company regulated by a provincial Act;
- A company to which the Trust and Loan Companies Act applies;
- A trust company regulated by a provincial Act;
- A loan company regulated by a provincial Act;
- A person or an entity authorized under provincial legislation to engage in the business of dealing in securities or any other financial instruments, or to provide portfolio management or investment advising services;
- A department or an agent of Her Majesty in right of Canada or of a province that is engaged in the business of accepting deposit liabilities.

This modification is expected to remove certain professionally managed trusts, such as family trusts and investment holding companies, from being considered financial institutions and thereby significantly reduce the burden of FATCA on such entities. Certain other entities, particularly investment entities, that would have otherwise been considered financial institutions under the Model 1 IGA may not meet the definition in the Legislative Proposals and work done to date to determine the FATCA status of an entity should be revisited in light of this new additional requirement.

Client name accounts
The Legislative Proposals provide for a modified definition of financial account and special rules regarding documentation responsibilities for accounts recorded on the books of an investment fund in client name. These provisions appear to be a framework for additional guidance that is expected to be included in the Guidance Notes related to how FATCA will apply to entities in the asset management industry (including fund manufacturers, dealers, investment advisors and portfolio managers). The definition of financial account will be expanded to include a client name account maintained by a person or entity that is authorized under provincial legislation to engage in the business of dealing in securities or any other financial instrument, or to provide portfolio management or investment advising services. An additional provision is included in the Legislative Proposals that indicates that investment fund manufacturers will be able to rely on FATCA account classifications provided by another financial institution, such as a dealer. It is anticipated that additional commentary on this issue will be included in the Guidance Notes.

Annex II modifications
Annex II generally lists certain entities that will be considered exempt or deemed compliant for purposes of FATCA and products that will be exempt from the requirements of FATCA. In general, Annex II to the Canadian IGA has been customized to address Canadian-specific entities and products and to remove certain items considered redundant or unnecessary. In addition to the products noted above that are specifically listed in the Annex, key differences between the Canadian IGA Annex II and the Model Annex II include:
• Entities qualifying as exempt beneficial owners under Annex II have been scaled back to four types of entities, including:
  – The Bank of Canada
  – Canadian offices of certain international organizations
  – Retirement funds (as described below)
  – Investment entities wholly owned by exempt beneficial owners

• The principal-based exemptions for retirement funds, including broad participation and narrow participation retirement funds, have been removed and a single exemption for retirement funds based on whether the plan or arrangement is described in paragraph 3 of Article XVIII of the Income Tax Convention between Canada and the United States is included in Annex II to the Canadian IGA.

• Unlike the Model Annex II, qualified credit card issuers, trustee-documented trusts and investment advisors and investment managers are not included as deemed compliant financial institutions in Annex II to the Canadian IGA.

• The following entities have been included in the Canadian IGA Annex II as deemed compliant financial institutions (new additions in italics):
  – Labor-sponsored venture capital corporations
  – Any central cooperative credit society whose accounts are maintained for member financial institutions
  – Entities described in Article XXI (Exempt Organizations) of the Income Tax Convention between Canada and the United States such as religious, charitable or educational organizations as well as entities that are operated exclusively to administer or provide pension, retirement or employee benefits
  – Restricted funds as defined in the US Treasury Regulations with certain modifications
  – Financial institutions with a local client base
  – Local banks (including certain banks and credit unions with total assets of less than $175 million that meet additional criteria)
  – Financial institutions with only low-value accounts
  – Sponsored investment entities and controlled corporations
  – Sponsored closely held investment vehicles
  – Certain collective investment vehicles.

For additional information with respect to this Alert, please contact the following:

Ernst & Young LLP (Canada), Toronto
• Jillian Nicolson +1 416 943 4474 jillian.nicolson@ca.ey.com
• Diamada Yannopoulos +1 416 943 3975 diamada.yannopoulos@ca.ey.com
About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2014 EYGM Limited.
All Rights Reserved.

EYG No. CM4169

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com