CANADA AND U.S. REACH AGREEMENT ON FOREIGN ACCOUNT TAX COMPLIANCE ACT

Finance Minister Jim Flaherty and National Revenue Minister Kerry-Lynne D. Findlay today announced that, after lengthy negotiations, Canada and the United States have signed an intergovernmental agreement under the longstanding Canada-U.S. Tax Convention.

In March 2010, the U.S. enacted the *Foreign Account Tax Compliance Act* (FATCA). FATCA would require non-U.S. financial institutions to report to the U.S. Internal Revenue Service (IRS) accounts held by U.S. taxpayers. Failure to comply with FATCA could subject a financial institution or its account holders to certain sanctions including special U.S. withholding taxes on payments to them from the U.S.

FATCA has raised a number of concerns in Canada—among both dual Canada-U.S. citizens and Canadian financial institutions. One key concern was that the reporting obligations in respect of accounts in Canada would compel Canadian financial institutions to report information on account holders who are U.S. residents and U.S. citizens (including U.S. citizens who are residents or citizens of Canada) directly to the IRS, thus potentially violating Canadian privacy laws.

Without an agreement in place, obligations to comply with FATCA would have been unilaterally and automatically imposed on Canadian financial institutions and their clients as of July 1, 2014.

Today's agreement addresses these concerns, as well as others.

Quick Facts

- Under the agreement, financial institutions in Canada will not report any information directly to the IRS. Rather, relevant information on accounts held by U.S. residents and U.S. citizens (including U.S. citizens who are residents or citizens of Canada) will be reported to the Canada Revenue Agency (CRA). The CRA will then exchange the information with the IRS through the existing provisions and safeguards of the Canada-U.S. Tax Convention. This is consistent with Canada's privacy laws.

- The IRS will provide the CRA with enhanced and increased information on certain accounts of Canadian residents held at U.S. financial institutions.

- Significant exemptions and relief have been obtained. For instance, certain accounts are exempt from FATCA and will not be reportable. These include Registered Retirement Savings Plans, Registered Retirement Income Funds, Registered Disability Savings Plans, Tax-Free Savings Accounts, and others. In addition, smaller deposit-taking institutions, such as credit unions, with assets of less than $175 million will be exempt.

- The 30 percent FATCA withholding tax will not apply to clients of Canadian financial institutions, and can apply to a Canadian financial institution only if the financial institution is in significant and long-term non-compliance with its obligations under the agreement.

- The agreement is consistent with Canada's support for recent G-8 and G-20 commitments intended to fight tax evasion globally and to improve tax fairness. In September 2013, G-20 Leaders committed to automatic exchange of tax information as the new global standard and endorsed a proposal by the Organisation for Economic Co-operation and Development to develop a global model for the automatic exchange of tax information. They also signaled an intention to begin exchanging information automatically on tax matters among G-20 members by the end of 2015.

- Draft legislation to implement the agreement will be released for comment shortly on the Department of Finance website.

Quotes

"Canada engaged in lengthy negotiations with the U.S. government to address our concerns and, as a result, significant exemptions and other relief were obtained."

- *Jim Flaherty, Minister of Finance*

"This is strictly a tax information-sharing agreement. This agreement will not impose any U.S. taxes or penalties on U.S. citizens or U.S. residents holding accounts in Canada. The CRA does not collect the U.S. tax liability of a Canadian citizen if the individual was a Canadian citizen at the time the liability arose. This includes dual Canada-U.S. citizens. That will not change under this agreement."

- *Kerry-Lynne D. Findlay, Minister of National Revenue*

Related Products

- Intergovernmental Agreement for the Enhanced Exchange of Tax Information under the Canada-U.S. Tax Convention [PDF]
- Backgrounder: Intergovernmental Agreement for the Enhanced Exchange of Tax Information under the Canada-U.S. Tax Convention (See below)
- Frequently Asked Questions: *Foreign Account Tax Compliance Act* (FATCA) and the Intergovernmental Agreement for the Enhanced Exchange of Tax Information under the Canada-U.S. Tax Convention (See below)

Media Contacts

Marie Prentice
Press Secretary
Office of the Minister of Finance
613-996-7861
Jack Aubry
Media Relations
Department of Finance Canada
613-996-8080

BACKGROUNDER
INTERGOVERNMENTAL AGREEMENT FOR THE ENHANCED EXCHANGE OF TAX INFORMATION UNDER THE CANADA-U.S. TAX CONVENTION

Canada and the U.S. have a long history of exchanging tax information, going back to the first comprehensive tax treaty signed between the two countries in 1942. The current *Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital* was first signed on September 26, 1980, and has been amended several times since.

The purpose of the Convention is to avoid double taxation (i.e., a situation where a taxpayer would have to pay tax on the same income twice, once in the U.S. and once in Canada) and to prevent the evasion of taxes on income and on capital, including through the exchange of tax information. The intergovernmental agreement (IGA) signed today will enhance that information exchange and support international efforts to improve the automatic exchange of tax information to fight tax evasion.

The IGA is consistent with Canada's support for the recent G-8 and G-20 commitments to develop a global standard for the automatic exchange of tax information.

The IGA takes into account the objectives and provisions of the U.S. *Foreign Account Tax Compliance Act* (FATCA), while supporting Canada's objectives for improving the integrity and fairness of the Canadian tax system. The IGA tailors the FATCA provisions to address Canadian concerns.

The IGA between Canada and the U.S. is similar to the ones negotiated with the United Kingdom and several other countries. To date, Bermuda, the Cayman Islands, Costa Rica, Denmark, France, Germany, Guernsey, Ireland, the Isle of Man, Italy, Japan, Jersey, Malta, Mauritius, Mexico, the Netherlands, Norway, Spain, Switzerland and the United Kingdom have signed agreements, nine other countries have reached an agreement in substance, and a large number of countries have been reported to be in negotiations with the U.S. to sign agreements.

Below are some key features of the IGA.

Reporting and Privacy

Canadian financial institutions will report information on their U.S. clients directly to the Canada Revenue Agency (CRA), which will ensure that the collection and use of the information is consistent with Canadian privacy laws. In addition, exchanged information will be protected by the provisions of the Canada-U.S. Tax Convention.

U.S. Taxes and Penalties

The IGA will not impose any new U.S. taxes or penalties for non-compliance with U.S. tax laws on U.S. persons holding accounts at Canadian financial institutions, or provide for additional assistance in collection beyond that already permitted by the Canada-U.S. Tax Convention. The IGA is strictly an information-sharing agreement.

The IGA also protects Canadians and Canadian financial institutions from the tax withholding provisions in FATCA.

Limits on Reporting

The IGA exempts key Canadian savings vehicles from being reviewed and reported on, including most federally registered accounts such as:

- Registered Retirement Savings Plans
- Registered Retirement Income Funds
- Pooled Registered Pension Plans
- Registered Pension Plans
- Tax-Free Savings Accounts
- Registered Disability Savings Plans
- Registered Education Savings Plans
- Deferred Profit Sharing Plans

Smaller deposit-taking institutions, such as credit unions, with assets of less than $175 million will be exempt.

Reciprocity

The IGA is reciprocal, meaning that information will flow both ways between the tax administrations of the two countries to assist each in administering its own domestic tax laws. The information exchanged will provide tax authorities with greater information on accounts held by their taxpayers in the other country.

Next Steps

The Government will introduce legislation at an early opportunity to implement the IGA.

The CRA will issue guidance to financial institutions on complying with the IGA, and will also provide information to taxpayers about the IGA on its website.

In accordance with the IGA, the implementing legislation, and the CRA guidance, financial institutions in Canada will begin applying their due diligence procedures starting in July 2014. Information reporting by financial institutions to the CRA and exchanges of information pursuant to the IGA will begin in 2015.

U.S. Tax Filing Obligations

Since 1913, U.S. persons in Canada, including dual citizens, have been required under U.S. tax law to file an annual U.S. federal income tax return with the U.S. Internal Revenue Service (IRS). In addition, since 1972, these persons have been obliged to file an annual Foreign Bank Account Reporting (FBAR) form with the U.S. Department of the Treasury.

The IRS has a streamlined process to recognize that some U.S. persons living abroad have not filed timely U.S. federal income tax returns or FBAR forms. Information on this process can be found on the IRS website.

FREQUENTLY ASKED QUESTIONS FOREIGN ACCOUNT TAX COMPLIANCE ACT (FATCA) AND THE INTERGOVERNMENTAL AGREEMENT FOR THE ENHANCED EXCHANGE OF TAX INFORMATION UNDER THE CANADA-U.S. TAX CONVENTION

What is FATCA?

On March 18, 2010, as part of the *Hiring Incentives to Restore Employment (HIRE) Act*, the United States (U.S.) enacted the provisions known as the *Foreign Account Tax Compliance Act* (FATCA).

FATCA requires non-U.S. financial institutions to enter into an agreement with the U.S. Internal Revenue Service (IRS) to report to the IRS accounts held by U.S. residents and U.S. citizens (including U.S. citizens that are residents or citizens of Canada). If a financial institution is not compliant with FATCA, FATCA requires U.S. payors (i.e., corporations and others that pay amounts, such as interest or a dividend) making certain payments of U.S.-source income to the non-compliant financial institution to withhold a tax equal to 30 percent of the payment. The 30 percent FATCA withholding tax can also be levied in respect of a compliant financial institution, on individual accountholders that fail to provide documentation as to whether they are U.S. residents or U.S. citizens, and on passive entities (i.e., entities whose business purpose is to generate passive income) that fail to identify their substantial U.S. owners, if any. In some circumstances, FATCA could require financial institutions to close the accounts of certain clients.

What would be the consequences for Canadians and financial institutions had the intergovernmental agreement (IGA) not been signed?

FATCA has raised a number of concerns in Canada – among both dual Canada-U.S. citizens and Canadian financial institutions. One concern is whether the FATCA reporting requirements, which would compel financial institutions to report information on accountholders that are U.S. residents and U.S. citizens directly to the IRS, would be consistent with Canada's privacy laws. Another concern is the possibility that, under FATCA, financial institutions would be required to deny services to certain clients in certain situations.

Absent an IGA, obligations for Canadian financial institutions to comply with FATCA would be unilaterally and automatically imposed on them by the U.S. as of July 1, 2014. These obligations would force Canadian financial institutions to choose between:

- entering into an agreement with the IRS that would require them to report directly to the IRS on accounts held by U.S. residents and U.S. citizens, which would raise concerns about consistency with Canadian privacy laws; or

- being subject to the 30 percent FATCA withholding tax on certain U.S.-source payments for not complying with FATCA.

Clients at Canadian financial institutions could also be subject to the 30 percent FATCA withholding tax or could have their accounts closed by their financial institution under the rules of FATCA for failing to comply with certain requirements that FATCA imposes on them.

Why is the U.S. interested in signing IGAs?

The intention of FATCA is to combat the use of offshore accounts to evade U.S. taxes by eliciting the transmission of information from non-U.S. financial institutions to the IRS. The U.S. has stated that it does not intend to raise revenues using the 30 percent FATCA withholding tax; this tax is intended solely as a means to induce non-U.S. financial institutions and their clients to comply. However, potential conflicts with the privacy rules in Canada, and a number of other leading economies, may prevent most major non-U.S. financial institutions from complying with FATCA in its original form. This raised the risk that FATCA would fail to achieve its main objective, and would create disruptive effects on financial markets through the imposition of the 30 percent FATCA withholding tax.

The Government of Canada advanced the principle that, in seeking to meet the objectives of FATCA, greater reliance should be placed on the exchange of information provisions that already exist in agreements such as the Canada-U.S. tax treaty. The Government is pleased that the U.S. accepted this principle, which led to the development of the IGA approach and its application worldwide as an alternative to FATCA. This approach fulfills the U.S. objective of enhanced information collection, without entailing the risk that a unilateral U.S. approach could conflict with foreign laws.

What are the benefits to Canada of the IGA?

Under the IGA:

- Canadian financial institutions will not report any information directly to the IRS. Rather, accountholder information on U.S. residents and U.S. citizens will be reported to the Canada Revenue Agency (CRA). The CRA will transfer the information to the IRS under the authority of the existing provisions of, and protected by the confidentiality safeguards under, the Canada-U.S. tax treaty.

- The 30 percent FATCA withholding tax will not apply to clients of Canadian financial institutions, and can apply to a Canadian financial institution only if the financial institution is in significant and long-term non-compliance with its obligations under the IGA.

- The FATCA requirement that Canadian financial institutions be required to close accounts or refuse to offer services to clients in certain circumstances will be eliminated.

- A number of accounts will be exempt from FATCA reporting, including Registered Retirement Savings Plans, Registered Retirement Income Funds, Registered Disability Savings Plans, and Tax-Free Savings Accounts.

- Smaller deposit-taking institutions, such as credit unions, with assets of less than $175 million will be exempt from reporting.

- The IRS will provide the CRA with enhanced and increased information on certain accounts of Canadian residents held at U.S. financial institutions.

Does the IGA mean that Canada will be enforcing U.S. tax laws?

Legislation to give effect to the provisions of the IGA will be proposed to Parliament in order to ensure that financial institutions can rely on Canadian law when implementing their procedures for complying with the IGA. The CRA, rather than the U.S., will be responsible for administering the IGA. Canadian financial institutions will report information to the CRA.

Will Canada be signing similar agreements with other countries?

The IGA is consistent with the Government's support for recent G-8 and G-20 commitments to multilateral automatic exchange of information for tax purposes. In September 2013, G-20 Leaders committed to automatic exchange of information as the new global standard and endorsed an OECD proposal to develop a global model for automatic exchange of information. The model being developed is based on due diligence and reporting procedures similar to those in the Canada-U.S. IGA.

Canada is actively participating in the work of the OECD to develop the new multilateral standard.

What are the next steps?

The IGA must be ratified by Canada in order to come into force. In order to ratify the IGA, Canada must first proceed with the implementation of the IGA into Canadian law, which will be carried out through implementing legislation that will be introduced in Parliament in the coming months.

Additional guidance on the implementation of the IGA will be available in the near future, including through the release of draft implementing legislation, which will be issued for comment, and publication by the CRA of detailed guidance for Canadian financial institutions and their clients.

Under the IGA, Canadian financial institutions will be required to begin due diligence procedures starting July 1, 2014, and to report information to the CRA beginning in 2015. The first exchange of information between the CRA and the IRS will be in 2015.

Does the IGA respect the privacy rights of Canadians?

FATCA has raised a number of concerns in Canada – among both dual Canada-U.S. citizens and Canadian financial institutions. One key concern was that the reporting requirements would force financial institutions to report accountholder information directly to the IRS, which would raise concerns about consistency with Canadian privacy laws.

Under the IGA, financial institutions in Canada will not report any information directly to the IRS. Rather, relevant information on U.S. residents and U.S. citizens will be reported to the CRA, similar to existing tax reporting by financial institutions to the CRA on their clients. The exchange of tax information between Canada and the U.S., including on an automatic basis, is already a longstanding practice, is authorized under Article XXVII of the Canada-U.S. tax treaty, and includes safeguards with respect to the use of the exchanged information. The information on U.S. accountholders obtained by the CRA will be exchanged with the IRS through these existing provisions, an approach that is consistent with Canadian privacy laws.

I am a U.S. citizen living in Canada and was not aware that the U.S. wants me to file tax returns. Will the IGA mean that I now have to pay U.S. taxes?

The IGA is strictly an information sharing agreement and does not involve the imposition by the U.S. of any new or higher taxes.

Unlike Canada, the U.S. taxes its citizens who reside in other countries on their worldwide income. The U.S. citizenship-based taxation regime has been in place since 1913, and is not altered by the enactment of FATCA, or the signing of any IGAs. For U.S. citizens resident in Canada, their U.S. tax obligations exist independently of their awareness of these obligations.

Canada respects the sovereign right of the U.S. to use citizenship as a basis for taxation. At the same time, citizenship-based taxation is a departure from the residence-based approach generally followed by Canada and most of the rest of the world, and creates unique challenges for U.S. citizens who reside in other countries. U.S. taxation of its non-resident citizens on their worldwide income, when these individuals are also subject to taxation on their worldwide income by their country of residence, can result in significant compliance burden on these individuals, even when they owe no U.S. tax.

What is the Government doing to protect dual citizens living in Canada against claims by the IRS?

While the Canada-U.S. tax treaty contains a provision that allows a country to collect the taxes imposed by the other country, the treaty does not apply to penalties under laws that impose only a reporting requirement. For example, the CRA will not assist in the collection of U.S. penalties associated with the Report on Foreign Bank and Financial Accounts (commonly known as the FBAR), which is a non-tax form required by the U.S. Treasury under the U.S. *Bank Secrecy Act* that requires the person filing the form to provide details of assets held at non-U.S. financial institutions.

Furthermore, the CRA will not collect the U.S. tax liability of a Canadian citizen if the individual was a Canadian citizen at the time the liability arose (whether or not the individual was also a U.S. citizen at that time).