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The Common Reporting Standard Comes to Canada

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Legislative proposals relating to implementation of the OECD Common Reporting Standard were announced by the Minister of Finance for Canada in April 2016. However, those proposals codified as part XIX of the Income Tax Act (ITA) did not become effective until July 1, 2017. Part XIX of the ITA is supplemented by Guidance on the Common Reporting Standard (the ''Guidance'') released by the Canada Revenue Agency (CRA) on March 22, 2017. While Canada is only one of 101 countries that have adopted the Common Reporting Standard (CRS), its legislation and guidance provide an example of CRS in practice.[1] Implementation of CRS may differ considerably from country to country.

This article considers CRS as implemented by Canada by comparing and contrasting its features with the Foreign Account Tax Compliance Act (FATCA) and concludes with comments regarding the vulnerabilities of both systems to easy evasion based upon the author's experience with the reactions of individual account holders targeted by these measures.

CRS is not FATCA. The two regimes use confusingly similar terminology and processes to elicit information subject to disclosure. However, the scope of CRS is broader: There is no minimum account balance (in lieu of the $50,000 account balance to which FATCA reporting is subject).[2] The list of financial institutions subject to due diligence and reporting obligations is broader inasmuch as CRS does not invoke the concepts of exempt beneficial owners and deemed-compliant financial institutions as FATCA does. For example, ''local banks'' (within the meaning of section III.B of Annex II of the Canada-U.S. Intergovernmental Agreement) and certain other institutions excluded by Annex II are nonetheless subject to CRS obligations.[3] CRS is a multilateral information exchange system among 101 countries. In contrast, FATCA is a largely unilateral information gathering system flowing in favor of the United States with respect to which the United States has limited reciprocal obligations. Finally and perhaps most significant in terms of CRS avoidance, the United States is not a CRS participating jurisdiction.

Despite the many differences, the two regimes share much in common. Generally, the same types of financial institutions are saddled with due diligence and reporting obligations. Tax-advantaged accounts common in Canada such as tax-free savings accounts (TFSAs), registered education savings plans (RESPs), registered retirement savings plans (RRSPs), and registered retirement income funds (RRIFs) — as well as similar tax-advantaged savings arrangements that are unlikely to be used by individuals who are tax residents of other countries — are not subject to CRS re-

[1] Of the 101 countries committed to adoption of CRS as of June 2017, 50 will begin automatic exchanges of information in 2017, and the remaining 51 will begin in 2018. The United States is not one of these countries.

[2] U.S. Internal Revenue Code, as amended (''Code'') §1471(d)(1)(B); Treasury Regulations (''Reg.'') §1.1471-5(a)(4)(i).

[3] *Compare* Agreement Between the Government of the United States of America and the Government of Canada to Improve International Tax Compliance Through Enhanced Exchange of Information Under the Convention Between the United States of America and Canada With Respect to Taxes on Income and on Capital (''Canada-U.S. IGA''), Annex II *with* ITA §270(1), definition of ''non-reporting financial institutions'' *and* Guidance §3.42.

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porting and are also exempt from FATCA reporting.[4] The distinction between active and passive non-financial entities (NFEs) for CRS reporting is identical to the distinction between active and passive non-financial foreign entities (NFFEs) for FATCA reporting.[5] Accounts held by publically traded companies, governmental entities, international organizations, and tax-exempt organizations are generally not subject to reporting under either regime.[6] Similarly, holding companies and treasury centers are regarded as active NFEs and NFFEs, respectively, under both CRS and FATCA.[7] Both regimes report generally the same kind of information, although CRS takes an added interest in the account holder's country of residence and taxpayer identification number (TIN) used by the resident country due to the multilateral character of CRS.[8]

Both regimes allow financial institutions to undertake due diligence by reliance upon self-certification and electronic database searches. Both regimes direct financial institutions to draw conclusions regarding the reportable status of an account holder based upon similar indicia.[9] Both regimes allow that indicia to be ignored if the account holder is willing to provide appropriate self-certification, unless the financial institution knows the self-certification is fraudulent.[10] Neither regime allows financial institutions to ignore what their relationship managers know.[11]

The due diligence imposed on financial institutions by CRS and FATCA is substantially identical, although the guidance provided by the FATCA regulations is considerably more detailed. Both regimes use a $1,000,000 threshold to distinguish between lower value and high-value individual accounts and the commensurate levels of due diligence required. For example, when the indicia which require reporting are not found in the case of lower value accounts, the financial institution is relieved of further due diligence until the account balance exceeds $1,000,000.[12] In addition, in the case of high-value accounts, when the required information is not revealed by electronic search of the financial institution's database, a paper search must be undertaken.[13] Pre-existing entity accounts below $250,000 do not require review or reporting.[14] However, while FATCA does not subject such accounts to due diligence until the balance exceeds $1,000,000,[15] CRS requires due diligence once the balance exceeds $250,000 on the last of any subsequent calendar year.[16]

FATCA and CRS reporting differ in other respects. The ''stick'' of FATCA — 30% withholding on income derived from U.S. investments without regard to treaty relief — is absent from the CRS regime. In fact, the only penalty is that imposed on an account holder who fails to provide a TIN.[17] That penalty is limited to $500 per occurrence.[18] The effective dates for FATCA due diligence procedures to be implemented and reporting to have commenced have fully passed. In contrast, CRS procedures in Canada only became effective on July 1, 2017.[19] Due diligence for pre-existing individual accounts is not required to be completed until 2020 in the case of lower value and 2019 in the case of high-value accounts.[20] In the case of pre-existing entity accounts, due diligence is not required to be completed until December 31, 2019, for accounts with balances in excess of $250,000 on June 30, 2017.[21] In the case of pre-existing entity accounts with balances of less than $250,000 on June 30, 2017 no due diligence or reporting is required until the account balance reaches that level on the last day of a subsequent calendar year, and then the due diligence need only be completed by December 31 of the following year.[22]

Perhaps the greatest commonality between CRS and FATCA is the ease with which both regimes may be avoided. CRS and FATCA both require disclosure of accounts and the information regarding the persons who own the accounts. Investments in land, businesses, collectables, jewelry, and apparel all escape reporting under both regimes. Further, disclosure under both regimes may be avoided with the cooperation of others. In the case of CRS, reporting is easily avoided by holding accounts in the name of an individual who is a resident of Canada. In the case of FATCA, reporting is easily avoided by holding ac-

[4] *See* Canada-U.S. IGA, Annex II, IV; ITA §270(1), definition of ''non-reporting financial institutions'' (f); Guidance §3.47.

[5] *See* Reg. §1.1472-1(c)(1)(iv); ITA §270(1), definition of ''active NFE'' (a).

[6] Code §1473(3)(A) through (E); ITA §270(1), definition of ''non-reporting financial institution'' (a) through (c).

[7] Canada-U.S. IGA, Annex I, VI.B.4(e); Guidance §4.5(d).

[8] *Compare* Code §1471(c)(1) *with* ITA §271(1).

[9] *Compare* Reg. §1.1471-4(c)(5)(iv); Canada-U.S. IGA Annex I, II.B.1, D.1 *with* ITA §273(2)(b), (3)(a).

[10] *See* Canada-U.S. IGA, Annex I, IV.D.1(b), VI.A; ITA §273(2)(f)(i)(B), (ii)(B), §277(1).

[11] *See* Canada-U.S. IGA, Annex I, VI.A; ITA §273(3)(d).

[12] Canada-U.S. IGA Annex I, II.B.2. ITA §273(2)(c).

[13] Reg. §1.1471-4(c)(5)(iv)(D)(3). ITA §273(3)(b).

[14] Reg. §1.1471-4(c)(3)(iii). ITA §275(1).

[15] Reg. §1.1471-4(c)(5)(iii)(A).

[16] *See* ITA §275(1).

[17] This is not intended to suggest that Canadian financial institutions which choose to ignore CRS obligations would escape the attention of their regulators.

[18] ITA §281(3).

[19] *See* ITA §275(2), (5); Guidance §8.5.

[20] ITA §273(4).

[21] ITA §275(5)(a).

[22] ITA §275(5)(b).

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counts in the name of someone who is not a U.S. person (citizen or resident of the United States). With such easy opportunities for avoidance, both regimes represent a greater threat to the unwary than to the truly calculating.

In another important respect CRS and FATCA differ. Because of the nature of the U.S. government and the controls to which it is subject, FATCA reporting is largely a tax problem for U.S. persons. In contrast, the concerns raised by CRS reporting are broader. While CRS is an exchange of information between tax authorities, it is this author's experience in assisting clients to establish trusts in the United States so as to avoid CRS reporting that the motivation of these individuals is the privacy and protection of their families who are resident in the home countries to which CRS reporting will be provided.[23] For countries whose controls on disclosure of financial information are easily subverted, CRS reporting is particularly problematic. Disclosures regarding the foreign assets of these individuals invite extortion, and in some cases kidnapping. Where these concerns are not present, often political risk is. In much of the world, when financial privacy is lost, personal safety and security soon follow.

[23] *See generally* Ward, *Planning for the Use of the United States as a Financial Haven: Part 1*, 45 Tax Mgmt. Int'l J. 677 (Nov. 11, 2016) and *Planning for the Use of the United States as a Financial Haven: Part 2*, 45 Tax Mgmt. Int'l J. 749 (Dec. 9, 2016).

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