FATCA in Canada: The Restriction on the Class of Entities Subject to FATCA

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NOTICE OF AMENDMENT
Please note that the online version of this article differs from the printed version in the following respects: 1) the addition of the phrase “which includes US citizens regardless of residence” to the text accompanying note 159; 2) the deletion of the text accompanying note 250; and 3) the deletion of note 250.

PRÉCIS
Le présent article constitue pour les Canadiens une introduction à la Foreign Account Tax Compliance Act (FATCA) et analyse la loi de mise en vigueur du Canada concernant la FATCA. La loi de mise en vigueur classifie de façon unique les entités assujetties à la FATCA, se démarquant ainsi de la classification dans les règlements du Trésor américain, dans l’accord intergouvernemental entre le Canada et les États-Unis sur la FATCA (l’IGA canadien), et dans la loi de mise en vigueur adoptée ou proposée par d’autres administrations fiscales qui ont signé des IGA avec les États-Unis. Ainsi positionnée, la loi de mise en vigueur place le Canada soit à l’avant-garde en matière de rédaction législative concernant la FATCA soit en porte-à-faux avec les États-Unis et ces autres administrations fiscales. Le présent article analyse la position et le raisonnement du Canada relativement à sa classification restrictive des entités assujetties à la FATCA en vertu de la loi de mise en vigueur, et conclut que l’interprétation de la loi est vraisemblablement discordante.

La FATCA est problématique pour toutes les parties concernées, autant dans le secteur privé que public. Malheureusement, la loi de mise en vigueur du Canada semble aggraver la situation. La loi limite la définition de l’IGA canadien d’« institution financière » à une liste exclusive de 13 types d’entités. Il reste à voir si cette restriction du Canada est appropriée. La loi de mise en vigueur classifie toutes les fiducies personnelles canadiennes, ou les fiducies familiales et autres fiducies privées qui sont des résidents du Canada, comme entités exonérées des exigences de l’IGA canadien, alors que ces fiducies seraient classifiées comme entités assujetties à l’IGA canadien en vertu des règlements du Trésor,

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de l'IGA lui-même, et de la loi de mise en vigueur d'autres administrations fiscales qui ont signé des IGA. En conséquence, le Canada embrouille l'application de la FATCA avec son IGA canadien et pourrait avoir unilatéralement annulé une entente internationale. En particulier, la loi pourrait produire une retenue excédentaire sur certains paiements aux entités canadiennes assujetties avec raison à la FATCA en vertu de l'IGA canadien — en particulier les fiducies personnelles canadiennes — ou pourrait empêcher l'IGA canadien d'entrer en vigueur. La retenue excédentaire augmenterait le fardeau de la FATCA pour les entités canadiennes visées en exigeant qu'elles récupèrent les retenues d'impôt autrement inutiles auprès de l'agent de retenue ou, plus probablement, de l'Internal Revenue Service.

NATURELLEMENT, LES NÉGOCIATIONS ENTRE LE DÉPARTEMENT DU TRÉSOR AMÉRICAIN ET LE MINISTÈRE DES FINANCES CANADIEN CONCERNANT LA FATCA SE SONT DÉROLUÉES DERrière DES PORTES Closes et on ne connaît pas les sujets de discussion des parties, leur nature et les ententes tacites qui auraient pu survenir. En conséquence, nous ne donnons pas notre avis sur l'exactitude de la loi de mise en vigueur canadienne, mais nous analysons plutôt la loi pertinente dans l'espoir que notre analyse serve de cadre à l'évolution de la loi de mise en vigueur étrangère concernant la FATCA au Canada et au-delà.

En particulier, le présent article analyse 1) la FATCA en général et l'IGA canadien en particulier; 2) les raisons pour lesquelles certaines fiducies personnelles canadiennes devraient être classifiées comme des entités assujetties à la FATCA en vertu de l'IGA canadien à titre d'entités de placement, d'établissements de garde de valeurs, ou les deux, et pourquoi le renvoi au Groupe d'action financière dans la définition d'entité de placement ne change pas cette classification; 3) la loi de mise en vigueur en vertu de l'IGA canadien, en particulier sa classification unique des fiducies personnelles canadiennes comme entités exonérées de l'IGA canadien, et un historique de la loi; et 4) les conséquences potentielles de limiter la catégorie d'entités assujetties à la FATCA en vertu de l'IGA canadien, notamment la retenue excédentaire et l'invalidation de l'IGA.

ABSTRACT
This article provides an introduction to the Foreign Account Tax Compliance Act (FATCA) for Canadians and analyzes Canada’s implementing legislation regarding FATCA. The implementing legislation uniquely classifies entities subject to FATCA, in that it departs from the classification in the US Treasury regulations, the Canada-US intergovernmental agreement regarding FATCA (the Canadian IGA), and the implementing legislation adopted or proposed by other jurisdictions with signed IGAs with the United States. Thus positioned, the implementing legislation places Canada either in the vanguard of legislative drafting regarding FATCA or as discrepant with both the United States and these other jurisdictions. This article analyzes Canada’s position and rationale for its restrictive classification of entities subject to FATCA under the implementing legislation, and concludes that the legislation is likely discrepant in its interpretation.

FATCA is problematic for all parties involved, in both the private and the public sectors. Unfortunately, Canada’s implementing legislation appears to exacerbate the situation. The legislation restricts the Canadian IGA’s definition of “financial institution” to an exclusive list of 13 types of entities. Whether Canada’s restriction on that term is proper remains to be seen. The implementing legislation classifies all personal Canadian trusts, or family trusts and other private trusts that are Canadian residents, as entities exempt from the Canadian IGA’s requirements, while these trusts would be classified as entities subject to the Canadian IGA under the Treasury regulations, the IGA itself, and the implementing legislation of other jurisdictions with signed IGAs. Consequently, Canada has obscured
the application of FATCA through the Canadian IGA and may have unilaterally overridden an international agreement. Specifically, the legislation could cause overwithholding on certain payments to Canadian entities properly subject to FATCA under the Canadian IGA—particularly personal Canadian trusts—or may prevent the Canadian IGA from entering into force. Overwithholding would increase FATCA’s burden on the affected Canadian entities by requiring them to recover the otherwise unnecessary withholding taxes from the withholding agent or, most likely, the Internal Revenue Service.

Of course, negotiations between the US Department of the Treasury and the Canadian Department of Finance regarding FATCA occurred behind closed doors, and it is uncertain what the parties discussed, the nature of any possible debate, and the tacit agreements that may have been reached. Accordingly, we do not opine on the correctness of the Canadian implementing legislation, but instead simply analyze the relevant law in the hope that our analysis will serve as a framework for the evolution of foreign implementing legislation regarding FATCA in Canada and beyond.

Specifically, this article analyzes (1) FATCA generally and the Canadian IGA in particular; (2) why some personal Canadian trusts should be classified as entities subject to FATCA under the Canadian IGA as investment entities, custodial institutions, or both, and why the Financial Action Task Force reference in the definition of an investment entity does not alter this classification; (3) the implementing legislation under the Canadian IGA, particularly its unique classification of personal Canadian trusts as entities exempt from the Canadian IGA, and a history of the legislation; and (4) the potential consequences of restricting the class of entities subject to FATCA under the Canadian IGA, including overwithholding and invalidation of the IGA.

KEYWORDS: TRUSTS ■ FATCA ■ US-CANADA ■ CROSS-BORDER ■ INTERGOVERNMENTAL AGREEMENT ■ TAX LEGISLATION

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INTRODUCTION

On February 5, 2014, Canada and the United States signed an intergovernmental agreement (“the Canadian IGA”) regarding the application of the US Foreign Account Tax Compliance Act (FATCA) to Canadian entities.1 The Canadian IGA relieves Canadian entities subject to FATCA from many of the onerous obligations that they would otherwise have faced under FATCA’s default regime. On the same day that the agreement was signed, the Department of Finance issued draft legislation, as required under Canadian law, to implement the Canadian IGA. A slightly modified version of the draft legislation was tabled in the House of Commons on February 11, 2014,2 and on June 19, 2014, the Canadian implementing legislation received royal assent.3

1 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, signed on February 5, 2014 (www.fin.gc.ca/treaties-conventions/pdf/FATCA-eng.pdf). The Foreign Account Tax Compliance Act was enacted on March 18, 2010, as subtitle A of title V of the Hiring Incentives to Restore Employment Act of 2010, Pub. L. no. 111-147 (herein referred to as “the HIRE Act”). The name “Foreign Account Tax Compliance Act” is, strictly speaking, an incorrect reference to the law that was enacted as part of the HIRE Act in 2010, but is a holdover from the original iteration of the 2009 legislation that did not become law. Foreign Account Tax Compliance Act of 2009, House Report 3933 (October 27, 2009). Title V, Subtitle A of the HIRE Act is headed “Foreign Account Tax Compliance,” omitting the word “Act.” But since this is the name that remains in widespread use by government officials, entities, and non-government commentators, we have adopted it here.

2 Bill C-31, An Act To Implement Certain Provisions of the Budget Tabled in Parliament on February 11, 2014 and Other Measures, first reading March 28, 2014 (herein referred to as either “the Canadian implementing legislation” or “the implementing legislation”). The relevant provisions of Bill C-31 are substantially similar to the draft legislation initially released by the Department of Finance: Canada, Department of Finance, Legislative Proposals Relating to the Canada–United States Enhanced Tax Information Exchange Agreement Implementation Act (Ottawa: Department of Finance, February 2014) (www.fin.gc.ca/drleg-apl/2014/can-us-eu-0214l-eng.aspx) (herein referred to as “the draft legislation”). When the House of Commons Standing Committee on Finance commenced its review of Bill C-31 in the spring of 2014, one of the authors of this article (Roy Berg) was called to testify on the proposed implementation legislation.

3 SC 2014, c. 20, enacting part XVIII, sections 263 through 269, of the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the ITA”).
FATCA classifies every “entity” (including trusts) as falling within one of two mutually exclusive groups: “foreign financial institution” (FFI) or “non-financial foreign entity” (NFFE). Generally, entities must comply with FATCA’s requirements, which differ depending on the entity’s classification as an FFI or an NFFE, or face a 30 percent withholding tax on certain US-source payments received. FFIs are generally required to enter into an “FFI agreement” with the US Internal Revenue Service (IRS) under FATCA to prevent this withholding, while NFFEs are not.

The IGAs with various foreign jurisdictions are surrogates for the default FATCA regime in the Code and the Treasury regulations, which generally make FATCA more palatable for those jurisdictions and their residents. The IGAs largely override this default regime; they are meant to facilitate the implementation of FATCA and to avoid any legal impediments under foreign law that would otherwise limit an entity’s ability to comply with its FATCA obligations, particularly in jurisdictions with stringent privacy laws. Nonetheless, an IGA is an incomplete surrogate since it operates in accordance with foreign law. Entities subject to FATCA under an IGA may satisfy their FATCA reporting obligations by reporting to the designated authority in their country of residence under that country’s laws, and that authority then reports to the IRS (Model 1 IGA); or the country of residence must enable such entities to report directly to the IRS (Model 2 IGA). Accordingly, the implementing legislation

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4 Defined in Treas. reg. section 1.1471-1(b)(35).
5 Sections 1471(a) and 1472(a) of the Internal Revenue Code of 1986, as amended (herein referred to as “the Code” or “IRC”). “Foreign financial institution” is defined in IRC section 1471(d)(4); “non-financial foreign entity” is defined in IRC section 1472(d). Unless otherwise noted, the word “foreign” is used in this article to refer to a person that is not a “United States person” under the definition in IRC section 7701(a)(30). See also IRC section 1473(5).
6 IRC sections 1471(a) and 1472(a).
7 IRC sections 1471(a) and (b)(1); Treas. reg. section 1.1471-4.
8 IRC sections 1472(b).
9 For a list of jurisdictions that have signed an IGA, see United States, Department of the Treasury, “FATCA—Archive” (www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca-archive.aspx) (herein referred to as “the FATCA archive”).
11 There are three versions of the Model 1 IGA and two versions of the Model 2 IGA (see infra note 13), and each model has its own pair of annexes. All US model IGAs can be found on the Treasury’s FATCA page: www.treasury.gov/resource-center/tax-policy/treaties/Pages/ FATCA.aspx.
of the foreign jurisdiction will initially govern whether an entity is subject to FATCA under a Model 1 IGA.\textsuperscript{12} Under the IGAs, only financial institutions are subject to FATCA’s requirements, including reporting, withholding, and due diligence, while non-financial institutions are not.\textsuperscript{13} The Canadian IGA is a Model 1 IGA; consequently, the Canadian implementing legislation will initially govern whether an entity is subject to FATCA under the IGA. Notably, the IGAs replace the FFI agreements and only modify the default rules for FFIs—and not the rules for NFFEs—under the Code and the Treasury regulations.\textsuperscript{14} Thus, entities properly classified as NFFEs will not be governed by the Canadian IGA or the Canadian implementing legislation to determine whether they are subject to FATCA; instead, they will be governed by the default rules in the Code and the Treasury regulations.

Personal trusts resident in Canada that are not regulated by Canadian law are directly affected by the definition of “financial institution” in the implementing legislation. These trusts are typically family trusts used frequently in Canada for a variety of legitimate and even statutorily sanctioned endeavours, including holding closely held businesses or other investments, income splitting, intergenerational wealth transfer, and post mortem planning. We refer to these types of trusts, which are both residents of Canada and properly classified as trusts under US tax law, as “personal Canadian trusts.”\textsuperscript{15}

The Canadian implementing legislation alters the definition of “financial institution”\textsuperscript{16}—one of the most important terms defined in the Canadian IGA—in a manner that appears to be inconsistent with the IGA, and is more restrictive than the Treasury regulations and the implementing legislation regarding FATCA that has been

\textsuperscript{12} Model 1A IGA, supra note 10, article 2; Canadian IGA, supra note 1, article 2.

\textsuperscript{13} For example, the Canadian IGA, supra note 1, articles 1(1) and 4(1), and annex I(I) and (VI)(B)(2); Model 1A IGA, supra note 10, articles 1(1) and 4(1), and annex I(I) and VI(B)(2).

\textsuperscript{14} Model 1A IGA, supra note 10, articles 2 through 4 and 4(1); Canadian IGA, supra note 1, articles 2 through 4 and 4(1).

\textsuperscript{15} IRC section 7701(a)(30)(E); Treas. reg. section 301.7701-4; and article IV of the Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital, signed at Washington, DC on September 26, 1980, as amended by the protocols signed on June 14, 1983, March 28, 1984, March 17, 1995, July 29, 1997, and September 21, 2007. A trust must fail either the court test or the control test in IRC section 7701(a)(30)(E) to constitute a foreign trust. IRC section 7701(a)(31)(B).
adopted or proposed in every other jurisdiction with a signed IGA. The implementing legislation explicitly provides that it governs in the event of any inconsistency between it and the Canadian IGA, and this restriction seemingly creates an inconsistency. Thus, the implementing legislation’s restrictive alteration of the Canadian IGA’s definition of a financial institution will exempt from the IGA, and perhaps even from FATCA entirely, entities that would otherwise be subject to FATCA under the provisions of the IGA, the Code and Treasury regulations, and the implementing legislation of other jurisdictions with IGAs.

In this article, we provide an introduction to FATCA in Canada and discuss the implementing legislation’s apparent limitation on Canadian entities subject to FATCA under Canadian law, particularly personal Canadian trusts. To understand how FATCA will work in Canada, it is important to recognize that there are three sources of substantive law that—at least in theory—are supposed to function in harmony (though practical impediments may cause some dissonance): the Code and the Treasury regulations, the Canadian IGA, and the Canadian implementing legislation. The Canadian implementing legislation is augmented by administrative guidance notes issued by the Canada Revenue Agency (CRA). The analysis that follows is based on these sources and is divided into five parts. First, we will discuss the purpose of FATCA in the context of the US system of worldwide income taxation. Second, we will provide a brief introduction to FATCA under both the default rules in the Code and the Treasury regulations and the IGAs. Third, we will address how personal Canadian trusts are classified under FATCA in the Code and Treasury regulations and in the Canadian IGA. Specifically, we will examine why personal Canadian trusts are properly classified as financial institutions subject to FATCA under the Code and the Canadian IGA as investment entities, custodial institutions, or both, and how the

16 Canadian IGA, supra note 1, article 1(1)(g).
17 ITA subsection 263(5). See also ITA subsection 91(4).
IGA’s reference to the recommendations of the Financial Action Task Force (FATF)\textsuperscript{20} does not alter this classification. Fourth, we will outline how personal Canadian trusts are improperly classified under the Canadian implementing legislation as entities exempt from the IGA, and perhaps even from FATCA entirely, and we will review the history of the legislation. Fifth, we will analyze the consequences to Canadians of excluding personal Canadian trusts from FATCA under the implementing legislation. Notably, the legislation could cause overwithholding on certain US-source payments to Canadian financial institutions—as defined by the Canadian IGA or US domestic law—particularly payments to personal Canadian trusts, or it could even prevent the Canadian IGA from entering into force.

**FATCA—A CONTEXTUAL OVERVIEW**

**FATCA’s Purpose and Worldwide US Taxation**

As background to our analysis, we will begin by identifying the purpose of FATCA, since it is important to keep that purpose in mind in considering the various provisions discussed below. FATCA is designed to detect and deter offshore tax evasion by persons subject to US taxation.\textsuperscript{21} FATCA fulfills its purpose by imposing reporting, withholding, and due diligence requirements on certain financial entities regarding those entities’ US account holders and owners.

To understand the harm that FATCA was designed to prevent, a brief overview of the US income tax system is in order. The United States is unique in that it taxes “United States persons” on their worldwide income.\textsuperscript{22} Worldwide US income taxation follows from the lack of limiting language on the taxation of persons. The Code is written broadly to potentially apply to any person in existence, regardless of whether that person resides in the United States. The Code begins by generally providing that “every individual” and “every corporation” may be subject to US tax on income “from whatever source derived.”\textsuperscript{23} This means that an individual or a corporation

\textsuperscript{20} The Financial Action Task Force is an independent intergovernmental body that develops and promotes policies to protect the global financial system. According to the FATF, the *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation—FATF Recommendations* (Paris: Financial Action Task Force, February 2012) are recognized as the global standard: Financial Action Task Force, “Who We Are” (www.fatf-gafi.org/pages/aboutus/). The document (referred to herein as “the FATF recommendations” and discussed later in this article) can be found at www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf.


\textsuperscript{22} IRC sections 1, 11, 641, 701, and 7701(b)(1); Treas. reg. section 1.1-1(b). The term “United States person” is defined in IRC section 7701(a)(30); see the text below at note 25.

\textsuperscript{23} IRC sections 1(a), 11(a), 61(a), and 63.
may be subject to US tax on any item of income earned or received, regardless of that person’s country of residence. But other provisions of the Code generally limit worldwide income taxation to United States persons. A “United States person” is generally defined as a US citizen or resident, a US corporation or partnership, a US-resident estate, or a US trust. Notably, US citizenship for tax purposes is determined by reference to US immigration law, which provides that individuals born in the United States and subject to its jurisdiction are US citizens. This is important to remember while rummaging through FATCA’s specific rules because FATCA was largely designed to identify US citizens, in order to fulfill its purpose of detecting and deterring tax evasion, particularly pertaining to its due diligence and payee identification requirements. In light of FATCA’s purpose, we will begin our journey into its labyrinth by discussing its antecedents and inception.

**FATCA’s Antecedents and Inception**

After the terrorist attacks on September 11, 2001, the United States realized that its position in the global economy, coupled with pressure on the global banking system, could prove to be a powerful weapon to fight money laundering and terrorism, and began implementing strategies to leverage its position to that end. In 2010, the US Congress enacted FATCA, which utilizes similar strategies to a different end—namely, as noted above, to detect and deter US persons that seek to avoid US tax by hiding income and assets in foreign jurisdictions.

FATCA is one of the most ambitious and controversial bodies of legislation in the recent history of taxation. It was born from the ashes of the UBS tax scandal, and seeks to combat offshore tax evasion by US persons through the use of non-US financial entities and investment structures. Historically, US persons seeking to evade US taxation have favoured this strategy because of the robust bank secrecy laws in many jurisdictions (notably, Switzerland). FATCA attempts to eliminate this type of

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24 IRC sections 2(d), 11(d), and 7701(a)(5), (a)(30), and (b)(1).
25 IRC section 7701(a)(30).
26 Treas. reg. section 1.1-1(c).
27 8 USC section 1401(a).
28 See the text accompanying notes 74-76 and 132-163, infra.
30 In this article, unless otherwise noted, references to a “US person” or “US persons” mean persons falling within the definition of “United States person” in IRC section 7701(a)(30).
31 See the Senate report, supra note 21, at 2; and *Congressional Record*, supra note 21, at S10785.
tax evasion by imposing an innovative withholding tax on certain US-source payments to specified foreign entities if the entities fail to report information regarding their US owners and account holders to the IRS, perform due diligence to discover these owners and account holders, and make any required withholdings.33

Information reported under FATCA can have grim consequences for US persons who have undisclosed funds offshore or are not compliant with their US tax-filing obligations. Non-compliant taxpayers who are reported to the IRS under FATCA may not be eligible to use the recently amended streamlined filing compliance procedures to catch up on their US filing obligations without incurring substantial penalties, since the information gleaned would presumably trigger an IRS audit and investigation; under the amended rules, the initiation of a civil or criminal investigation by the IRS will preclude taxpayers from using the streamlined filing procedures.34 Accordingly, non-compliant taxpayers should take action to remedy their non-compliance sooner rather than later.

The primary criticisms of FATCA appear to be that (1) it is unilateral, (2) it is extraterritorial, and (3) it improperly passes on the costs of detecting tax evasion—traditionally borne by government—to private parties.35 Canada’s former finance minister Jim Flaherty was one of FATCA’s most outspoken critics. He said, for example, that FATCA would “turn Canadian banks into extensions of the IRS” and ultimately fail to achieve anything “except waste resources on all sides.”36 FATCA has also been criticized, using a cost-benefit analysis, for placing an unjustifiably high financial burden on the world’s financial entities to deter and detect US tax evasion; indeed, it has been suggested that the implementation costs for entities subject to FATCA will exceed the US tax revenues raised.37

Some believe that FATCA will not withstand the test of time because it is overly broad and overreaching,38 and others question the validity of the IGAs under either

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33 IRC sections 1471(a), 1472(a), 1473(1)(A), and 1474.
35 Blank and Mason, supra note 32, at 1246.
US or foreign law. Notably, before the Canadian IGA was signed, the pre-eminent Canadian constitutional law scholar Peter W. Hogg argued that an IGA based on one of the US model IGAs—which is precisely what the Canadian IGA is—would violate the Canadian constitution. But his view is not shared by all. We will not take a side in this debate, but assume that FATCA is valid under both US and Canadian law.

Whether by rueful concession or enlightened embrace, jurisdictions and financial entities have begun to accept FATCA and the changes that FATCA has wrought to their internal processes as a means of combatting tax evasion and money laundering. In fact, numerous jurisdictions have introduced or imposed their own versions of FATCA, and even the new common reporting standard (CRS) adopted by the Organisation for Economic Co-operation and Development (OECD) for the automatic exchange of information between tax authorities worldwide is built on the foundation laid by the IGAs.

To be implemented effectively, FATCA and FATCA-like legislation require standard definitions. The OECD CRS emphasizes that the standardized automatic exchange of financial account information is key to its success, the benefits of which include process simplification, higher effectiveness, and lower costs for all parties involved. “A proliferation of different and inconsistent models would potentially impose significant costs on both government and business to collect the necessary information and operate the different models.” This is critical, because the costs of complying with FATCA and FATCA-like legislation are expected to be in the billions (US) for banks and other affected entities, and these costs will be borne by the account holders and owners of those entities. Furthermore, because tax evasion is a

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44 Ibid., at 7.

45 Ibid.

46 Wood, supra note 37.
global issue, the standard used must have a global reach to actually solve the problem rather than merely reallocate it to other jurisdictions with lower reporting thresholds.47

**FATCA BASICS UNDER THE CODE AND THE IGAS**

FATCA is a dauntingly complex body of law. Although the Code provisions span fewer than 10 pages,48 the Treasury regulations (final, temporary, and proposed) and their preambles recently surpassed the 700-page mark,49 not to mention the five model IGAs and their annexes,50 numerous IRS guidance materials,51 43 signed IGAs with various jurisdictions (as of October 1, 2014),52 and 58 IGAs in substance that are treated as in effect (as of October 1, 2014).53 Although originally scheduled to take effect after 2013,54 FATCA withholding has been delayed and now applies to “withholdable payments”55 made starting July 1, 2014.56 In Notice 2013-43, the IRS agreed that certain jurisdictions will be treated as having an IGA in effect even though the particular jurisdiction has signed an IGA but has not yet brought it into force.57 Notice 2014-33 announced that 2014 and 2015 will be transition periods for IRS enforcement and administration of FATCA’s reporting, withholding, and due diligence requirements, including a good-faith efforts standard under the Treasury regulations.58

48 IRC sections 1471 through 1474.
50 See the FATCA page on the Treasury’s website, supra note 11.
52 See the FATCA archive, supra note 9.
53 IRS Announcement 2014-17, 2014-17 IRB 1; FATCA archive, supra note 9.
54 HIRE Act, supra note 1, section 501(d).
55 Defined in IRC section 1473(1)(A); Treas. reg. sections 1.1471-1(b)(145) and 1.1473-1(a).
56 IRS Notice 2013-43, supra note 51.
57 Ibid. This was later confirmed by IRS Announcement 2014-17, supra note 53. This announcement also provided that certain countries that have reached an agreement in substance with the United States on the terms of their IGAs will be treated as having an agreement in effect until the end of 2014. The Treasury website lists these jurisdictions in the FATCA archive, supra note 9. For entry into force, see the Canadian IGA, supra note 1, article 10(1), and the Model 1A IGA, supra note 10, article 10(1).
58 IRS Notice 2014-33, 2014-21 IRB 1. Generally, Notice 2014-33 announces the IRS’s intent to amend the Treasury regulations and portions of future IGAs to include the following: (1) a provision allowing withholding agents or entities subject to FATCA to treat certain entity obligations (including accounts) as pre-existing accounts for FATCAs reporting, withholding, and due diligence requirements; (2) additional guidance regarding FFIs that are members of expanded affiliated groups; (3) modification of the standards of knowledge under Treas. reg. section 1.1441-7(b) for withholding agents regarding accounts documented before July 1, 2014;
When boiled down to its essence, FATCA forces certain foreign entities to serve as information gatherers and couriers for the IRS by imposing various reporting, withholding, and due diligence obligations on entities with US account holders or owners. As we have noted, FATCA was designed to combat offshore tax evasion by US persons, and it does so indirectly by imposing an expansive and powerful withholding tax on certain payments of US-source income to specified foreign entities that fail to comply with the FATCA regime. Practically, this means that foreign entities such as banks will report information regarding their US owners and account holders to the IRS, and the IRS will presumably use this information to pursue these persons if they are not compliant with their US tax-filing obligations or have undisclosed funds offshore.

Under both the Code and the Canadian IGA, a “specified United States person” is subject to FATCA reporting and withholding. A “specified United States person” is a “United States person” other than certain publicly traded corporations, tax-exempt organizations, individual retirement plans, US government entities, US banks, real estate investment trusts, regulated investment companies, common trust funds, and charitable remainder trusts. As discussed above, the Code defines a “United States person” to mean a US citizen or resident, a US corporation or partnership, a US-resident estate, or a US trust. The definition in the Canadian IGA is essentially the same, with some variation in wording.

FATCA introduces over 150 defined terms, which can have different meanings depending on where the entity resides. If an entity is resident in a country with an IGA, the IGA will generally govern. An entity resident in a country without an IGA is governed by the default rules in the Code and the Treasury regulations. We will cover the analysis under the Code and regulations before analyzing the IGAs in general and the Canadian IGA in particular. As will become apparent, compared to

and (4) revision of the definition of a “reasonable explanation supporting a claim of foreign status” in Treas. reg. section 1.1471-3(e)(4)(viii). Interestingly, this notice does not mention good-faith efforts under the IGAs, although countries are permitted to allow their residents to opt into the due diligence requirements in the Treasury regulations. See, for example, the Canadian IGA, supra note 1, annex I(D)(C). Perhaps the revised Treasury regulations reflecting Notice 2014-33 will address this inconsistency.

60 IRC sections 1471(b)(1)(A) and (D), (c)(1), and (d)(1); Canadian IGA, supra note 1, articles 4(1), 1(1)(cc), and 1(1)(ff).
61 IRC section 1473(3); Canadian IGA, supra note 1, article 1(1)(ff).
62 See generally IRC section 7701(b). A US resident includes an individual who has obtained a lawful permanent resident card (green card), whether or not that individual continues to reside in the United States. Treas. reg. section 301.7701(b)-1(b).
63 Compare IRC section 7701(a)(30), temp. Treas. reg. section 1.1471-1T(b)(141), and the Canadian IGA, supra note 1, article 1(1)(ee).
64 See, for example, Treas. reg. section 1.1471-1(b), temp. Treas. reg. section 1.1471-1T(b), and the Canadian IGA, supra note 1, article 1.
the Code and regulations, the IGAs generally provide a more favourable regime for all parties subject to FATCA.

**FATCA Under the Code and the Treasury Regulations**

As we have noted, FATCA classifies every entity into one of two mutually exclusive groups, as an FFI or an NFFE. Certain FFIs and NFFEs must report information regarding the accounts and other ownership interests of US persons or face a 30 percent withholding tax on “withholdable payments”—that is, US-source payments of interest, dividends, royalties, and gross proceeds from sales of assets that can produce US-source interest or dividends. An FFI is a financial institution that is a “foreign entity” defined as an entity that is not a “United States person.” A “financial institution” is generally defined as an entity that accepts deposits in the ordinary course of a banking or similar business; holds financial assets for the account of others as a substantial portion of its business; or engages primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or an interest in any of the immediately preceding items. The Treasury regulations further divide financial institutions into the following categories:

1. depository institution,
2. custodial institution,
3. investment entity,
4. “insurance company or holding company;” and
5. “holding company or treasury center.”

An FFI must enter into an FFI agreement with the IRS and obtain a “global intermediary identification number” (GIIN) in order to avoid FATCA withholding, unless

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66 IRC sections 1471(a) and 1472(a).

67 IRC section 1473(1)(A).

68 IRC section 1471(d)(4); Treas. reg. section 1.1471-1(b)(42).

69 IRC sections 1473(1)(A) and 7701(a)(30); Treas. reg. section 1.1473-1(e); temp. Treas. reg. section 1.1471-1T(b)(141).

70 IRC section 1471(d)(5).

71 Treas. reg. section 1.1471-5(e)(1). Note that certain entities are excluded from the FFI definition, including excepted non-financial group entities, excepted non-financial startup companies, excepted non-financial entities in liquidation or bankruptcy, excepted interaffiliate FFIs, IRC section 501(c) entities, and non-profit organizations. Treas. reg. section 1.1471-5(e)(5).
the FFI qualifies for an exclusion.\textsuperscript{72} An FFI agreement obligates the FFI to perform due diligence regarding its account holders and payees, make information reports to the IRS, withhold on certain withholdable payments, and even close the accounts of a US account holder where foreign law prevents FATCA reporting and the FFI cannot obtain a waiver from the holder to fulfill the reporting requirement.\textsuperscript{73} Different due diligence requirements apply depending on whether the account holder is an individual or an entity and when the account was opened.\textsuperscript{74} An FFI that cannot determine whether an account holder is a US person within the time period prescribed in the Treasury regulations (which is generally 90 days for new accounts and up to two years for “preexisting accounts”) must treat the holder as a “recalcitrant account holder.”\textsuperscript{75} An FFI is generally required to withhold on payments to a recalcitrant account holder, report the account holder to the IRS, and possibly close the holder’s accounts.\textsuperscript{76} Since the due diligence requirements in the Treasury regulations are generally similar to those in the Canadian IGA, we will cover them in detail below.

NFFEs are defined in the negative as entities that are not FFIs.\textsuperscript{77} An NFFE is not required to report as much information as an FFI, and generally must either certify\textsuperscript{78} that it does not have a “substantial United States owner”\textsuperscript{79} or report its US owner to the relevant withholding agent in order to escape FATCA withholding.\textsuperscript{80} A “withholding agent” is defined in the Code as any person that controls, receives, has custody or disposal of, or pays a withholdable payment.\textsuperscript{81} Prior to making a withholdable payment, the withholding agent must submit the information provided by the NFFE to the IRS,\textsuperscript{82} or it will be liable for the withholding that would otherwise

\textsuperscript{72} IRC section 1471(b); Treas. reg. section 1.1471-4(e)(1). “Global intermediary identification number” is defined in Treas. reg. section 1.1471-1(b)(57). As will be elaborated below, there are exclusions from FATCA reporting for certain entities.

\textsuperscript{73} IRC section 1471(b)(1); Treas. reg. section 1.1471-4.

\textsuperscript{74} Treas. reg. sections 1.1471-4(c)(3) through (5).

\textsuperscript{75} Treas. reg. sections 1.1471-4(c)(4)(i) and (5)(i). The relevant time period is determined by Treas. reg. section 1.1471-5(g)(3)(i) or (ii).

\textsuperscript{76} Treas. reg. section 1.1471-4(a)(1); temp. Treas. reg. section 1.1471-4T(a)(3).

\textsuperscript{77} IRC section 1472(d); Treas. reg. section 1.1471-1(b)(80). Note that certain NFFEs are excepted from FATCA withholding, including publicly traded corporations, certain affiliated entities related to a publicly traded corporation, certain territory entities, active NFFEs, excepted non-financial entities, direct reporting NFFEs, and sponsored direct reporting NFFEs. Treas. reg. section 1.1472-1(c)(1); temp. Treas. reg. section 1.1472-1T(c)(1).

\textsuperscript{78} IRS form W-8BEN-E, “Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities),” is used for this purpose.

\textsuperscript{79} Defined in IRC section 1473(2).

\textsuperscript{80} IRC section 1472(b).

\textsuperscript{81} IRC section 1473(4).

\textsuperscript{82} IRC section 1472(b)(3). Note that the withholding agent must not know or have reason to know that the information provided is incorrect. IRC section 1472(b)(2).
be due. Unlike FFIs, NFFEs are not required to enter into an agreement with the IRS to comply with their FATCA obligations.

FATCA withholding cannot be reduced or eliminated by tax treaty; the only way to avoid it is by providing the information required by FATCA or qualifying for an exclusion. The information that FFIs and NFFEs report is generally limited for use in determining US tax obligations, although the identity of FFIs may be disclosed and is required by withholding agents in order to discharge their due diligence obligations. FATCA withholding is generally treated as withholding under IRC sections 1441 through 1446; however, no credit or refund is allowed unless the beneficial owner of the payment triggering the withholding provides the IRS with the information needed to determine (1) whether the owner is a “United States owned foreign entity” and (2) the identity of any substantial US owners of that entity.

FFIs may obtain a credit or refund on FATCA withholding if they are entitled to a reduced rate under a tax treaty, and if so, the credit or refund is limited to the extent of the treaty reduction and no interest is allowed thereon. If more than one person qualifies as a withholding agent regarding a single withholdable payment, only one FATCA withholding must be collected. Generally, the withholding agent will be the person that last controlled the withholdable payment. Withholding agents are personally liable for FATCA withholding. The withholding agent must ascertain the identity and status of the payee under FATCA before making a withholdable payment. The payee generally must establish its FATCA status by providing documentation, including form W-8BEN-E.

The withholding rules under the IGAs are similar to those under the Code and the Treasury regulations, albeit a much more benign (or less draconian, depending

83 IRC section 1474(a).
84 IRC section 1472(b)(3).
85 IRC sections 1471(a), 1472(a), 1473(1)(A), and 1474(a); temp. Treas. reg. section 1.1471-2T(a)(1); Treas. reg. section 1.1472-1(a).
86 IRC sections 1474(c)(1), 3406(f), and 6103; TD 9658, supra note 49.
87 IRC section 1474(c)(2); Treas. reg. section 1.1471-3.
88 IRC section 1474(b)(1).
89 Defined in IRC section 1471(d)(3).
90 IRC section 1474(b)(3).
91 IRC section 1474(b)(2)(A).
92 Treas. reg. section 1.1474-1(a)(1).
93 Treas. reg. section 1.1473-1(d).
94 IRC section 1474(a).
95 Treas. reg. section 1.1471-3.
96 Form W-8BEN-E, supra note 78; Treas. reg. section 1.1471-3(b)(2). FATCA status is referred to as “chapter 4 status” under the regulations. Treas. reg. sections 1.1471-3(b) and 1(b)(82).
on your point of view) regime applies. For example, only a “nonparticipating financial institution” is subject to FATCA withholding under the Canadian IGA.97

The IGAs Generally

The IGAs provide a different set of rules for residents of the relevant IGA jurisdiction, which largely trump the FATCA rules under the Code and the Treasury regulations.98 The US Department of the Treasury, the department responsible for drafting and negotiating the IGAs, entered into these agreements to ease the burden of exchanging information under foreign law and make compliance with FATCA feasible, particularly in jurisdictions where entities may not be able to comply with FATCA owing to local legal impediments.99 Consequently, the IGAs rely on cooperation between the foreign country and the United States to facilitate the exchange of information under FATCA.

As discussed earlier, there are two basic model IGAs, Model 1 and Model 2. The Model 1 IGA allows financial institutions resident in countries with IGAs to satisfy their FATCA obligations by reporting the relevant information regarding their US owners and account holders directly to the designated authority in their country of residence, which then reports to the IRS. These financial institutions are not required to enter into an FFI agreement.100 There are two subtypes of the Model 1 IGA: a reciprocal Model 1A IGA, and a non-reciprocal Model 1B IGA. The Model 1B IGA is further divided into two versions: one for countries with an existing tax information exchange agreement (TIEA) or double tax convention (DTC), and one for those without.101

The Model 2 IGA differs from the Model 1 in that it is non-reciprocal and provides that financial institutions must report directly to and enter into an FFI agreement with the IRS; in addition, the resident country must enable financial institutions to collect and exchange the FATCA information required and to register with the IRS.102

97 Canadian IGA, supra note 1, article 4(1), postamble, and article 5(2).
98 Preamble to Treas. reg. section 1.1471-0, TD 9610, 2013-15 IRB 765; Model 1A IGA, supra note 10, article 4(1); Canadian IGA, supra note 1, article 4(1). Note, however, that countries with Model 1A IGAs (including Canada) may permit financial institutions to use the definitions in the Treasury regulations instead of the definitions in the IGA if this use would not “frustrate the purposes of” the IGA. See the Model 1A IGA, supra note 10, article 4(7); and the Canadian IGA, supra note 1, article 4(7). See also the Model 1A IGA, supra note 10, annex I(I)(C); and the Canadian IGA, supra note 1, annex I(I)(C). In addition, when it comes to defining an entity as an FFI, the Treasury regulations explicitly bend to the IGAs. Treas. reg. section 1.1471-5(d).
99 See, for example, the Model 1A IGA, supra note 10, paragraph 5 of the preamble; and the Canadian IGA, supra note 1, paragraph 5 of the preamble.
100 Model 1A IGA, supra note 10, article 4(1).
101 FATCA archive, supra note 9.
102 “Model 2 IGA, Preexisting TIEA or DTC,” supra note 13, articles 2 and 3(1); “Model 2 IGA, No TIEA or DTC,” supra note 13, articles 2 and 3(1).
Like the Model 1 IGA, there are two subtypes of the Model 2 IGA: one for countries with an existing TIEA or DTC, and one for those without. 103 The model IGAs also include two annexes, which are generally similar regardless of the IGAs' type. 104 The IGAs have their own set of definitions, which generally follow the definitions in the Code and the Treasury regulations. 105 The IGAs still classify entities into one of two mutually exclusive groups, as a financial institution or a non-financial institution. But a financial institution is defined somewhat differently in the IGAs as compared with an FFI under the Code and regulations, and the IGAs do not include a definition of a non-financial institution (apart from the definition of the term “NFFE” for due diligence purposes). 107 An entity that is not a financial institution is by implication a non-financial institution exempt from the requirements under the IGAs, though it would still be subject to FATCA under the default rules in the Code and regulations as a NFFE. 108 The Treasury regulations expressly provide that an entity resident in a country with an IGA in effect is an FFI if it is a financial institution under that IGA. 109 Accordingly, the IGAs' classification rules regarding whether an entity is a financial institution subject to FATCA trump the Treasury regulations. Specifically, the IGAs split financial institutions into four categories: 110

1. custodial institution,
2. depository institution,
3. investment entity, and
4. specified insurance company.

As described above, the Model 1A IGA provides that financial institutions may satisfy their FATCA obligations by reporting the relevant information directly to the designated authority in their country of residence, and that authority then reports to the IRS. 111 All Model 1 IGAs depend heavily on foreign law to work. The IGAs generally provide that financial institutions will be treated as FATCA-compliant if they fulfill their obligations under foreign law to identify certain US account holders.
and owners, and if their country of residence complies with its requirements under the relevant IGA.\textsuperscript{112} The country of residence generally must implement its own laws to obtain and exchange the requisite information regarding reportable accounts in the time and manner prescribed by its IGA.\textsuperscript{113} Accordingly, the role of Canada’s implementing legislation is to ensure that Canada’s responsibilities under the Canadian IGA can be properly discharged to facilitate FATCA’s execution in Canada through the IGA. While countries with Model 1 IGAs require foreign law for implementation, a Treasury official has indicated that foreign law must be substantially similar to the Code and the Treasury regulations in classifying financial institutions subject to FATCA. Ronald Dabrowski, IRS deputy associate chief counsel (international), stated, “[K]eep in mind that the IGAs will be under foreign law and will develop on their own, but the scope is meant to be the same.”\textsuperscript{114}

**The Canadian IGA**

The Canadian IGA is nearly identical to the current Model 1A IGA, excepting certain defined terms; therefore, we will limit our discussion accordingly.

All Canadian financial institutions are classified into one of three types: a reporting Canadian financial institution, a non-reporting Canadian financial institution, or a non-participating financial institution. A “reporting Canadian financial institution” is defined in the negative as a Canadian financial institution that is not a non-reporting Canadian financial institution.\textsuperscript{115} A “non-reporting Canadian financial institution” is defined as a Canadian financial institution or other Canadian-resident entity\textsuperscript{116} that is identified as such in annex II or that otherwise qualifies as a deemed-compliant FFI or an exempt beneficial owner (EBO) under the Treasury regulations.\textsuperscript{117} Furthermore, a reporting Canadian financial institution will be treated as compliant with FATCA and not subject to withholding under article 4(1) of the Canadian IGA if the following conditions are met:\textsuperscript{118}

1. Canada complies with its obligations under the Canadian IGA regarding that institution; and
2. the institution registers with the IRS, obtains a GIIN, reports certain information to the Canadian competent authority (that is, the CRA), and withholds on certain withholdable payments.

\textsuperscript{112} Ibid.
\textsuperscript{113} Model 1A IGA, supra note 10, articles 2 and 3; Canadian IGA, supra note 1, articles 2 and 3.
\textsuperscript{115} Canadian IGA, supra note 1, article 1(1)(o).
\textsuperscript{116} Defined in article 1(1)(gg), ibid. See also ibid., annex II.
\textsuperscript{117} Ibid., article 1(1)(q). Deemed-compliant FFIs and EBOs are discussed in a separate section below.
\textsuperscript{118} Ibid., article 4(1).
The Treasury regulations provide that a reporting Canadian financial institution that complies with the registration requirements in the Canadian IGA is a registered deemed-compliant FFI. Reporting Canadian financial institutions for which Canada meets its obligations and that meet their own obligations under the Canadian IGA, though not subject to FATCA withholding themselves, must still withhold on withholdable payments not specified in article 4(1) or will face personal liability for that withholding. In other words, reporting Canadian financial institutions that otherwise comply with FATCA are not required to withhold to maintain their own exemptions from withholding under article 4(1), but must follow the default withholding rules in the Code and Treasury regulations nonetheless, since the Canadian IGA does not preclude the application of those rules. As noted, the penalty for failure to withhold is personal liability for the non-withheld amount.

Reporting Canadian financial institutions are not required to enter into FFI agreements, though their responsibilities under the Canadian IGA are generally similar to those under an FFI agreement. The information reported must include the reporting Canadian financial institution’s “US reportable accounts” and the name of any non-participating financial institution to which it has made payments. Importantly, US reportable accounts do not include certain tax-saving accounts and other products, listed in annex II of the Canadian IGA, such as tax-free savings accounts (TFSAs) and various registered savings plans. Generally, under the IGA, the Canadian government (in practice, the CRA) must provide the IRS with specific information regarding each US reportable account of each reporting Canadian financial institution.

As noted above, a non-reporting Canadian financial institution is a Canadian financial institution or other Canadian-resident entity that qualifies as an EBO or a deemed-compliant FFI under either the Canadian IGA or the Treasury regulations in effect when the IGA was signed. Non-reporting Canadian financial institutions are essentially exempt from FATCA’s requirements. Notably, non-reporting Canadian financial institutions will be treated as certified deemed-compliant FFIs, which are not required to register with the IRS.

119 Treas. reg. sections 1.1471-1(b)(111) and 5(f)(1).
120 IRC section 1474(a); Treas. reg. section 1.1474-1; temp. Treas. reg. section 1.1471-3T(f)(9).
121 Ibid. Compare with Treas. reg. section 1.1471-4.
122 Defined in article 1(1)(cc) of the Canadian IGA, supra note 1.
123 Ibid., articles 4(1)(a) and (b). Note that the latter requirement applies only for 2015 and 2016.
124 Canadian IGA, supra note 1, annex II(IV). The Treasury regulations provide similar exceptions. Treas. reg. section 1.1471-5(b)(2).
125 Canadian IGA, supra note 1, article 2(2)(a). The CRA will also report certain information regarding the Canadian reportable accounts of each US financial institution. Ibid., article 2(2)(b). Discussion of this reporting is outside the scope of this article.
126 IRC section 1471(b)(4); Treas. reg. sections 1.1471-5(e)(5) and 1.1471-6.
127 Treas. reg. section 1.1471-1(b)(14); temp. Treas. reg. section 1.1471-5T(f)(2).
A “nonparticipating financial institution” is generally a reporting financial institution whose significant non-compliance with its FATCA obligations exceeds 18 months after the first notification of significant non-compliance was provided.\footnote{Canadian IGA, supra note 1, articles 1(1)(r) and 5(2)(b); Treas. reg. section 1.1471-1(b)(82).} Classification as a non-participating financial institution is disastrous because that is the only way that a reporting Canadian financial institution is subject to FATCA withholding under the Canadian IGA. Specifically, a reporting Canadian financial institution that does not comply with its obligations under article 4(1) of the Canadian IGA is not subject to FATCA withholding unless the IRS treats it as a non-participating financial institution under article 5(2)(b).\footnote{Canadian IGA, supra note 1, article 4(1), postamble.} It would be quite the feat for an institution to fall under article 5(2)(b), given the requirement of continued significant non-compliance for a period exceeding 18 months. To purge its classification as a non-participating financial institution, a reporting Canadian financial institution must remedy its significant non-compliance.\footnote{Ibid., articles 4(1) and 5(2).} A reporting Canadian financial institution that makes a payment to a non-participating financial institution must report that payee to the CRA (but note that this requirement applies only for 2015 and 2016).\footnote{Ibid., article 4(1)(b).}

The Canadian IGA imposes due diligence requirements on reporting Canadian financial institutions that generally follow the requirements imposed by FFI agreements under the Treasury regulations. Different requirements apply depending on whether the account holder is an individual or an entity.\footnote{Ibid., annex I(II) through (V).} For present purposes, we will limit our discussion to individuals. (The due diligence requirements are generally the same for entity account holders, except that entities are allowed higher monetary exemption amounts.)\footnote{See, for example, ibid., annex I(IV)(A).} Similar to the due diligence requirements in the Treasury regulations, the requirements in the Canadian IGA distinguish between pre-existing accounts and new accounts. A pre-existing account is an account existing before July 1, 2014, and a new account is an account opened on or after that date.\footnote{Ibid., annex I(II), (III), and (VI)(B)(5).} Certain account balance aggregation and currency translation rules apply for determining the various monetary thresholds under the due diligence requirements.\footnote{Ibid., annex I(VI)(C).} Moreover, a reporting Canadian financial institution cannot rely on self-certifications

128 Canadian IGA, supra note 1, articles 1(1)(r) and 5(2)(b); Treas. reg. section 1.1471-1(b)(82).
129 Each country has an affirmative duty to notify the other of significant non-compliance with the requirements under the Canadian IGA by a reporting financial institution in the other country. Canadian IGA, supra note 1, article 5(2)(a). For example, if the CRA knows that a reporting Canadian financial institution is significantly non-compliant with its obligations under the Canadian IGA, it must report that institution to the IRS.
130 Ibid., articles 4(1) and 5(2).
131 Ibid., article 4(1)(b).
132 Ibid., annex I(II) through (V).
133 See, for example, ibid., annex I(IV)(A).
134 Ibid., annex I(II), (III), and (VI)(B)(5).
135 Ibid., annex I(VI)(C).
or documentary evidence obtained under the due diligence requirements if it knows or has reason to know that the certification or documentation is incorrect or unreliable.\textsuperscript{136} The due diligence requirements for pre-existing accounts differ depending on the value of the account as follows:

1. Accounts not exceeding US$50,000, cash value insurance or annuity contracts not exceeding US$250,000 on June 30, 2014, and cash value insurance or annuity contracts that cannot be effectively sold to US residents under Canadian or US law are not required to be reviewed, identified, or reported as US reportable accounts.\textsuperscript{137} The exemption of these accounts from the due diligence procedures does not, however, prevent reporting Canadian financial institutions from actually reviewing, identifying, or reporting them. Indeed, many such institutions may well choose to do so, since it is probably cheaper to send out the requisite IRS forms (W-8 and W-9) to account holders in bulk, as opposed to sifting through all of the institution’s accounts. These exemptions from the due diligence requirements are consistent with the Treasury regulations.\textsuperscript{138}

2. Lower-value accounts—those exceeding US$50,000 (US$250,000 for a cash value insurance contract or annuity contract) but not exceeding US$1 million—must be reviewed by an electronic record search for certain listed US indicia—facts indicating that the account holder is a US citizen or resident, such as a US place of birth or mailing address—by June 30, 2016, so that the reporting Canadian financial institution can ascertain whether the account holder is indeed a US person subject to FATCA (in which case, the institution must identify and report the holder’s US reportable accounts to the IRS).\textsuperscript{139} Notably, the electronic search is not required to identify all of the listed US indicia.\textsuperscript{140} If US indicia are not discovered, nothing further is required until there is a change in circumstances that results in the discovery of US indicia or the account becomes a high-value account.\textsuperscript{141} If any US indicia are discovered, the reporting Canadian financial institution must treat the account as a US reportable account unless it elects otherwise and one of four specific exceptions applies.\textsuperscript{142}

\textsuperscript{136} Ibid., annex I(VI)(A). The IRS will consider good-faith efforts to comply with the Treasury regulations regarding FATCA’s reporting, withholding, and due diligence requirements for 2014 and 2015. See IRS Notice 2014-33, supra note 58, at III, and our additional comments in that note regarding opting-in provisions.

\textsuperscript{137} Canadian IGA, supra note 1, annex I(II)(A). Additionally, note the modifications in notice 2014-33 regarding pre-existing entity accounts. IRS Notice 2014-33, supra note 58, at IV.

\textsuperscript{138} Treas. reg. section 1.1471-4(c)(5)(iii); IRS Notice 2014-33, supra note 58, at IV.

\textsuperscript{139} Canadian IGA, supra note 1, annex I(II)(B)(1) and (II)(C)(1); Treas. reg. section 1.1471-4(c)(5)(iv)(B).

\textsuperscript{140} Canadian IGA, supra note 1, annex I(II)(B)(1).

\textsuperscript{141} Ibid., annex I(II)(B)(2).

\textsuperscript{142} Ibid., annex I(II)(B)(3). The exceptions are contained in annex I(II)(B)(4).
The most troubling of the exceptions is the first one, which allows an account holder to rebut unambiguous information indicating a US place of birth by
a. self-certifying that the holder is not a US citizen or resident for tax purposes;
b. providing a non-US passport or other government-issued identification showing foreign citizenship or nationality; and

c. providing either a certificate of loss of US nationality (CLN) or a “reasonable explanation” of why the holder does not have a CLN despite relinquishing US citizenship, or why the holder did not obtain US citizenship at birth.

Account holders without a CLN who opt to provide a reasonable explanation of why they are not US citizens will certainly invite additional IRS scrutiny; and, in any event, it is unclear what constitutes a reasonable explanation. Moreover, account holders who wish to rebut by obtaining a CLN may be in for a reckoning if a CLN is actually issued and the exit tax in IRC section 877A would apply on the date of issuance. Critically, the issuance of a CLN triggers notice to the IRS even though it is obtained from a different US government agency, so that the IRS can ensure that taxpayers cannot escape the exit tax (if applicable). The above due diligence requirements are consistent with the Treasury regulations.

3. High-value accounts—those exceeding US$1 million—must be reviewed by an electronic record search for US indicia (the same indicia listed for lower-value accounts). In addition, certain paper records must be searched to the extent that the electronic search is insufficient to collect other specified information. These searches must be completed by June 30, 2015, and reporting Canadian financial institutions must identify and report such high-value US reportable accounts to the IRS. Additionally, reporting Canadian financial institutions must question a high-value account holder’s “relationship manager,” or investment adviser, to determine whether the manager actually knows that the holder is a specified US person.

143 Ibid., annex I(II)(B)(4)(a).
144 Recall that, generally, an individual who is born in the United States becomes a US citizen at that time. 8 USC section 1401(a). See also IRS Notice 2014-33, supra note 58, at IV.
145 IRC section 877A(g)(4)(C). See also IRC section 7701(a)(50)(A).
146 IRC section 6039G(d)(2).
147 Treas. reg. section 1.1471-4(c)(5)(iv).
148 Canadian IGA, supra note 1, annex I(II)(D)(1) through (3).
149 Ibid., annex I(II)(E)(1).
150 Treas. reg. section 1.1471-1(b)(112). Since this term is not otherwise defined in either the Canadian IGA or the implementing legislation, presumably, the definition in the Treasury regulations applies. Canadian IGA, supra note 1, article 1(2).
151 Canadian IGA, supra note 1, annex I(II)(D)(4).
inquiry must be repeated annually, and the reporting Canadian financial institution must implement procedures to ensure that the manager identifies any change in circumstances regarding each high-value account. The remaining due diligence requirements are similar to those for lower-value accounts. These due diligence requirements are also consistent with the Treasury regulations.

4. Finally, if a reporting Canadian financial institution previously obtained documentation from an account holder establishing that the holder is not a US citizen or resident, in order to meet the institution’s obligations for certain other US tax purposes, it is not required to complete the due diligence requirements for lower-value accounts or the requirements for high-value accounts except the relationship manager inquiry. The Treasury regulations provide a similar exemption.

The due diligence requirements for new accounts also differ depending on the value of the account:

1. Depository accounts and cash value insurance contracts not exceeding US$50,000 at the end of any calendar year or other appropriate reporting period are not required to be reviewed, identified, or reported as US reportable accounts. Similar to the exemptions for pre-existing accounts, reporting Canadian financial institutions are allowed to review, identify, and report these accounts as US reportable accounts despite these exemptions. These due diligence requirements are consistent with the Treasury regulations.

2. For all other new accounts, the reporting Canadian financial institution must obtain self-certification from the account holder that allows the institution to determine whether the holder is a US resident for tax purposes, and to confirm the reasonableness of the certification when the account is opened or within 90 days after the account ceases to be an exempt account as described above. If the self-certification establishes that the account holder is a US resident for tax purposes—which includes US citizens regardless of residence—the reporting Canadian financial institution must treat the account as a US reportable account and obtain the holder’s taxpayer identifying number. If there is a change in circumstances regarding an account giving the

152 Ibid., annex I(II)(E)(3) and (5).
153 Treas. reg. section 1.1471-4(c)(5)(iv)(D).
154 Canadian IGA, supra note 1, annex I(II)(F). See also IRS Notice 2014-33, supra note 58, at V.
155 Treas. reg. section 1.1471-4(c)(5)(ii).
156 Canadian IGA, supra note 1, annex I(III)(A); ITA subparagraph 264(1)(b).
157 Treas. reg. section 1.1471-4(c)(4).
158 Canadian IGA, supra note 1, annex I(III)(B)(1).
159 Ibid., annex I(III)(B)(2).
reporting Canadian financial institution knowledge or reason to know that the account holder’s original self-certification is incorrect or unreliable, the financial institution must obtain a valid self-certification establishing whether the holder is a US citizen or resident for tax purposes; if it cannot do so, it must treat the account as a US reportable account. These due diligence requirements are also consistent with the Treasury regulations.

The Canadian IGA is reciprocal; however, the United States is not required to provide Canada with the same information that Canada must provide. Under the Canadian IGA, the United States only “acknowledges the need to achieve equivalent levels of reciprocal automatic information exchange with Canada,” declaring that it is committed to further improve transparency and enhance the exchange relationship with Canada by pursuing the adoption of regulations and advocating and supporting relevant legislation to achieve such equivalent levels of reciprocal automatic information exchange.

**EBOs and Deemed-Compliant FFIs**

EBOs and deemed-compliant FFIs occupy a special seat at the FATCA table. Under the Code and the IGAs, payments to EBOs are generally exempt from FATCA withholding, and deemed-compliant FFIs are excluded from FATCA withholding and reporting. Under the Treasury regulations, if a certain type of EBO receives a withholdable payment connected with a commercial financing activity, it will not be treated as an EBO for that payment and FATCA withholding will apply. It is unclear whether this commercial financing activity exception applies under the IGAs.

The Canadian IGA seemingly provides three opportunities for an entity to qualify as an EBO or a deemed-compliant FFI. First, an entity will be treated as an EBO or a deemed-compliant FFI if it is a non-reporting Canadian financial institution and otherwise qualifies as an EBO or a deemed-compliant FFI under either the

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160 Ibid., annex I(III)(B)(3).
161 Treas. reg. section 1.1471-4(c)(4).
162 Canadian IGA, supra note 1, paragraph 4 of the preamble, and article 6(1).
163 Ibid., article 6(1). See also article 6(4) and paragraph 6 of the preamble. Similar language is included in the Model 1A IGAs with other countries. Model 1A IGA, supra note 10, articles 6(1) and (4), and paragraph 6 of the preamble.
164 These terms are defined in the Treasury regulations, but not in the Canadian IGA. See Treas. reg. sections 1.1471-1(b)(27) and (42).
165 IRC section 1471(f); Treas. reg. section 1.1471-6; Canadian IGA, supra note 1, article 4(3) and annex II(II); Model 1A IGA, supra note 10, article 4(3) and annex II(II).
166 IRC section 1472(b)(2); Treas. reg. section 1.1471-5(f); Canadian IGA, supra note 1, article 4(3) and annex II(III); Model 1A IGA, supra note 10, article 4(3) and annex II(III) and (IV).
167 Treas. reg. section 1.1471-6(h).
Code and Treasury regulations or the Canadian IGA. Second, an entity may qualify as an EBO or a deemed-compliant FFI under the Canadian IGA. Third, an entity may qualify as an EBO or a deemed-compliant FFI if it is a Canadian retirement plan identified in annex II of the Canadian IGA and otherwise qualifies as an EBO or a deemed-compliant FFI.

Generally, EBOs are foreign governments, including any political subdivisions or wholly owned agencies thereof, foreign central banks, governments of US territories, certain foreign retirement funds, and certain entities owned by EBOs. Deemed-compliant FFIs fall into three major categories under the Treasury regulations:

1. registered deemed-compliant FFI,
2. certified deemed-compliant FFI, and
3. owner-documented FFI.

An entity does not automatically qualify as a deemed-compliant FFI under the Code and Treasury regulations; it must take some affirmative action to obtain this status. Yet entities that qualify as EBOs or deemed-compliant FFIs under the Canadian IGA receive more favourable treatment than those qualifying under the Code and regulations, since they are not required to take affirmative action to so qualify. Generally, the rules under the Canadian IGA for EBOs and deemed-compliant FFIs are similar to the rules in the Treasury regulations.

As indicated above, there are special rules in the Canadian IGA for Canadian retirement plans. Although the Canadian IGA provides that the United States must treat the Canadian retirement plans in annex II as EBOs or deemed-compliant FFIs under IRC sections 1471 and 1472, this provision is an “as appropriate” clause. Consequently, Canadian retirement plans will qualify as EBOs or deemed-compliant FFIs under article 4(3) of the IGA if they would otherwise meet those definitions. Since the terms “exempt beneficial owner” and “deemed-compliant FFI” are used in article 4(3) without initial capitals and neither of these terms is defined in the IGA, presumably the definitions in the Code and regulations apply.

168 Canadian IGA, supra note 1, articles 1(1)(q) and 4(4). This opportunity follows from the definition of non-reporting Canadian financial institution.

169 Ibid., annex II(II) and (III).

170 Ibid., article 4(3). See also article 1(1)(q).

171 IRC section 1471(f); Treas. reg. section 1.1471-6; Canadian IGA, supra note 1, annex II(II) and article 1(1)(q).

172 IRC section 1471(b)(2); Treas. reg. section 1.1471-5(f).

173 Treas. reg. sections 1.1471-5(f)(1) through (3) and (f)(1)(ii); Canadian IGA, supra note 1, article 4(1).

174 Canadian IGA, supra note 1, annex II(II) and (III).

175 Ibid., annex I(II) and (III).

176 Ibid., article 4(3); see also article 4(4).
PERSONAL CANADIAN TRUSTS SHOULD BE CLASSIFIED AS FINANCIAL INSTITUTIONS UNDER THE CANADIAN IGA

As we have noted, the Canadian IGA defines “financial institution” to mean a custodial institution, a depository institution, an investment entity, or a specified insurance company. Before delving into the definitions of the latter terms, it is necessary to read the Canadian IGA holistically for perspective. When read holistically, the text of the Canadian IGA supports the conclusion that certain personal trusts are financial institutions.

In defining the term “equity interest,” the Canadian IGA explicitly refers to “a trust that is a financial institution.” This language is broad, such that the definition applies to determine the equity interests for any trust, and not just trusts that are widely held or offered to the public, as the implementing legislation provides. Furthermore, the Canadian IGA defines “entity” to mean “a legal person or a legal arrangement such as a trust.” Why would trusts be directly referred to in these definitions if they were not subject to FATCA under the Canadian IGA? If the US Treasury had intended to exclude trusts from the definition of “financial institution,” it could have easily done so by omitting the references to trusts in the definitions of “equity interest” and “entity.” Statutory construction principles provide that interpretations that would render unnecessary other provisions or text of a statute or that would defeat the statute’s policy must be avoided. The Canadian implementing legislation accomplishes precisely that by reading all personal trusts out of the Canadian IGA through its restriction on the definition of a financial institution.

Also note the omission of annex II(IV)(A) of the Model 1A IGA from the Canadian IGA. That provision creates an exclusion from FATCA for trusteed-documented trusts, or trusts with certain financial institutions as trustees that report the information required under an IGA on their behalf. This omission suggests that the United States intends to treat certain Canadian trusts as financial institutions subject to FATCA under the Canadian IGA.

The intent of the US Congress and the Treasury department—the primary drafter of the Canadian IGA—should also be examined to determine the classification of

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177 Ibid., article 1(1)(g).
178 Ibid., article 1(1)(v).
179 See ITA paragraphs 263(1)(j) and (k). See also Treas. reg. section 1.1473-1(b)(3)(ii) for the elaborate rules applicable for determining a person’s beneficial interest in a trust, which even include references to the tables in IRC section 7520. Notably, the types of public trusts covered by the implementing legislation probably would not qualify as trusts under US tax law, as explored further below. See the text accompanying notes 194 and 239, infra.
180 Canadian IGA, supra note 1, article 1(1)(gg).
182 Model 1A IGA, supra note 10, annex II(IV)(A).
personal trusts under FATCA. It is unclear whether the US Congress intended to classify trusts as financial institutions subject to FATCA when the law was originally introduced in 2009 and enacted in 2010. A US Senate subcommittee has previously described trusts as “enablers” of tax evasion and abuse, suggesting that trusts are properly subject to FATCA. The term “trust” is used only six times in the relevant sections of the Code, and never in the context of a financial institution. The Treasury regulations, however, are replete with references to trusts, and two examples explicitly provide that trusts can be financial institutions. Other jurisdictions with Model 1A IGAs have also classified trusts as financial institutions subject to FATCA. The United Kingdom’s guidance notes specifically contemplate that certain trusts will be classified as financial institutions, and Ireland’s guidance notes echo this conclusion.

The OECD CRS confirms that an effective reporting regime should “limit the opportunities for taxpayers to circumvent reporting by using interposed legal entities or arrangements,” by requiring financial institutions to look through “shell companies, trusts or similar arrangements” to determine who the individual behind the account or ownership interest actually is. Accordingly, although Congress’s intent is unclear, the US Treasury and other jurisdictions with IGAs treat certain personal trusts as financial institutions subject to FATCA. That treatment is inconsistent with the treatment of personal trusts under the Canadian implementing legislation.

In this section, first we will address the classification of certain personal trusts as investment entities subject to FATCA under the Canadian IGA. Second, we will analyze the FATF reference in the definition of “investment entity” and explain why it should not be used to restrict that definition under the Canadian IGA, and cannot be used to restrict the more general term “financial institution.” Third, we will examine the classification of certain personal trusts as custodial institutions subject to FATCA under the Canadian IGA.

183 See Congressional Record, supra note 21, at S10785.
185 See IRC sections 1471 through 1474.
186 Treas. reg. section 1.1471-5(e)(4)(v), examples 5 and 6.
189 OECD CRS, supra note 43, at 7-8.
Certain Personal Canadian Trusts Should Be Classified as Investment Entities Under the Canadian IGA

An investment entity is defined under the Canadian IGA as follows:

The term “Investment Entity” means any Entity that conducts as a business (or is managed by an entity that conducts as a business) one or more of the following activities or operations for or on behalf of a customer:

1. Trading in money market instruments (cheques, bills, certificates of deposit, derivatives, etc.); foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures trading;
2. Individual and collective portfolio management; or
3. Otherwise investing, administering, or managing funds or money on behalf of other persons.

This subparagraph 1(j) shall be interpreted in a manner consistent with similar language set forth in the definition of “financial institution” in the Financial Action Task Force Recommendations.190

This definition is not meant to be read lightly; it employs dense, technical language that is easier to understand when digested one piece at a time.

First, note that only an “entity” can be an “investment entity.” In Canada and most common-law jurisdictions, trusts are “legal relationships,” not entities. Trusts are entities, however, under FATCA. As noted above, the Canadian IGA defines “entity” as “a legal person or a legal arrangement such as a trust.”191 Furthermore, under the Treasury regulations, an “entity” is “any person other than an individual,”192 and a “person” is “an individual, a trust, estate, partnership, association, company or corporation.”193

Second, ignoring the parenthetical phrase “managed by . . . ” in the first sentence and the FATF reference in the postamble (which we address separately below), it is relatively clear that trusts do not fall under the definition of an investment entity.


191 Canadian IGA, supra note 1, article 1(1)(gg).
192 Treas. reg. section 1.1471-1(b)(39).
193 Temp. Treas. reg. section 1.1471-1T(b)(100); IRC section 7701(a)(1).
Trusts do not have “customers,” if that word is given its traditional meaning; they have beneficiaries.194 Furthermore, a trust generally cannot be engaged in a business to qualify as such under US tax law.195 Accordingly, the parenthetical phrase is necessary to ensure that a trust will qualify as an investment entity for US tax purposes.

Third, the “managed by” relaxes the customer requirement by providing that trusts are investment entities if they are managed by an entity that is in the business of providing the three enumerated services to customers.

Fourth, the Canadian IGA does not explain what is meant by “managed by.” The Treasury regulations, however, add some clarity by providing two examples showing that the threshold is not very high.196 The management component is satisfied—and the trust is an investment entity under the Treasury regulations—if the trustee manages the trust itself or the investment assets of the trust.197 Mere advice, however, may not constitute management.198

In summary, if we ignore the reference to FATF, a personal Canadian trust will be classified as an investment entity—and therefore as a financial institution subject to FATCA—if

1. either
   a. the trust has a professional trustee or
   b. the assets of the trust are managed by a professional manager; and
2. the professional trustee or manager is not an individual person.199

This conclusion is consistent with the guidance notes issued by the United Kingdom and Ireland regarding FATCA. The UK guidance notes specifically state that trusts are investment entities if they are managed by a financial institution.200 The Irish guidance notes echo the United Kingdom’s position.201 The Treasury regulations

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194 See Treas. reg. section 301.7701-4(a). The term “customer” is not defined in either the Canadian IGA or the Treasury regulations.

195 Treas. reg. section 301.7701-4(b). Business trusts may be reclassified as corporations or partnerships for US tax purposes. See also Morrissey v. Commissioner, 296 US 344 (1935).

196 Treas. reg. section 1.1471-5(e)(4)(v), examples 5 and 6.

197 Ibid., example 6.


200 UK guidance notes, supra note 187, at sections 2.28 and 2.36.

201 Irish guidance notes, supra note 188, at chapter 2(2)(C).
state, and IRS and Treasury officials believe, that a personal trust will be an FFI subject
to FATCA if an entity performs management functions on behalf of the trust, regardless
of the assets it holds.\textsuperscript{202}

Thus, certain personal Canadian trusts will qualify as investment entities—and
therefore as financial institutions subject to FATCA under the Canadian IGA—unless
the FATF reference alters this treatment. The FATF reference, however, cannot be
accorded that much weight, as we shall see below.

\textit{The Reference to the FATF Recommendations}

As we have noted, the postamble of the definition of “investment entity” explicitly
states that the definition is to be interpreted “in a manner consistent with similar
language” in the FATF’s definition of a financial institution.\textsuperscript{203} The wording of this
instruction does not invite interpretations consistent with \textit{dissimilar} language in the
FATF definition, nor does it invite a reading of the FATF reference into the IGA’s
more general definition of a financial institution. The FATF reference is present in
the definition of “investment entity” in all the model IGAs, including those signed
with the United Kingdom and Ireland.\textsuperscript{204} Public statements made by Canada’s De-
partment of Finance show that it believes that the FATF reference in the definition
of “investment entity” excludes personal trusts from that definition.\textsuperscript{205} This inter-
pretation would exclude such trusts from FATCA if the FATF reference is understood
to alter the analysis above and is read into the more general definition of “financial
institution” in the Canadian IGA.

Close examination of the FATF definition of “financial institution”\textsuperscript{206} does little
to clarify the definition of “investment entity” in the Canadian IGA; yet the FATF
definition is explicitly, clearly, and unambiguously referenced. How, then, should
this reference be incorporated? Fundamental tenets of statutory construction dic-
tate that reliance on the FATF reference should not result in an interpretation of the

\begin{footnotes}
\textsuperscript{202} T reas. reg. section 1.1471-5(e)(4)(v), examples 5 and 6; Coder and Sheppard, supra note 114
(statements by Ronald Dabrowski, IRS deputy associate chief counsel, and Steven Musher, IRS
associate chief counsel (international)); and Sheppard, supra note 198, at 1165 (statement by
Jesse Eggert, former Treasury associate international tax counsel).

\textsuperscript{203} A similar requirement of consistency with the FATF recommendations is included in the IGAs
definition of “controlling persons.” Canadian IGA, supra note 1, article 1(1)(mm).

\textsuperscript{204} See United States, Department of the Treasury, Resource Center, “Foreign Account Tax
Compliance—Model Intergovernmental Agreements” (www.treasury.gov/resource-center/
tax-policy/treaties/Pages/FATCA.aspx); and supra note 190, UK IGA, article 1(1)(j), and Irish
IGA, article 1(1)(j).

\textsuperscript{205} Dean DiSpalatro, “Finance Bites Back at FATCA Criticism,” advisor.ca, April 2, 2014
(www.advisor.ca/tax/tax-news/finance-bites-back-at- FATCA-criticism-148790). The
Department of Finance presumably reads the FATF reference into the definition of “financial
institution” in article 1(1)(g) of the Canadian IGA.

\textsuperscript{206} FATF recommendations, supra note 20, at 116-17.
\end{footnotes}
Canadian IGA that is inconsistent with any other provisions of the agreement. 207
Reliance on the FATF definition of “financial institution” is probably unwarranted
because (as we explain in more detail below), first, it is contrary to the text of the
Canadian IGA and the “managed by” parenthetical phrase; second, it is overinclusive
and would render other definitions superfluous; and third, it is inconsistent with the
type of persons that can be classified as entities subject to FATCA under the IGA.
Moreover, the Finance department’s interpretation improperly reads the FATF refer-
ence out of the definition of “investment entity” into the more general definition of
“financial institution” and is contrary to comments made by a Treasury official. 208
Consequently, the reference to the FATF recommendations does little to advance a
clear understanding of the term “financial institution” and should not be relied
upon—particularly not as support for a more restrictive interpretation of “investment
entity” under the Canadian IGA or any permutation of the meaning of “financial
institution” under the implementing legislation. 209 With these inconsistencies, it is
difficult to obtain meaningful clarification of the term “investment entity” by refer-
ence to the FATF recommendations. It is even more difficult to interpret investment
tility “in a manner consistent with similar language” in the FATF definition of “fi-
nancial institution,” as the Canadian IGA instructs.

First, the FATF definition does not contain language similar to the “managed by”
parenthetical phrase in the Canadian IGA’s definition of “investment entity.” Accord-
ing to the FATF recommendations, trusts may be financial institutions if they trade
in certain financial instruments; engage in portfolio management; administer cash
or liquid securities on behalf of others; or otherwise invest, administer, or manage
funds or money on behalf of others. 210 Moreover, to qualify as a financial institution
under the recommendations, a personal trust must conduct its business “for or on
behalf of a customer.” 211 The latter requirement would preclude many trusts from
qualifying as a financial institution under the recommendations (since trusts have
beneficiaries, not “customers”), but no such requirement is present in the definition
of “investment entity” under the Canadian IGA. An investment entity does not have
to conduct business for or on behalf of a customer under the Canadian IGA if it is
managed by an entity that does so. 212

Second, the FATF definition of “financial institution” is overinclusive and renders
other provisions of the Canadian IGA superfluous. Numerous entities classified as

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207 Eskridge and Frickey, supra note 181, at 98.
208 See Sheppard, supra note 198, at 1165.
209 See ITA subsection 263(2).
210 FATF recommendations, supra note 20, at 116-17.
211 Ibid. “Customer” is not defined. Note that certain trusts may be “designated non-financial
businesses and professions”—and thus not financial institutions—under the FATF
recommendations (see ibid., at 113-14), although including trusts in this category is certainly
212 Canadian IGA, supra note 1, article 1(1)(j), preamble (parenthetical phrase).
financial institutions under the FATF definition fall outside the definition of “investment entity” under the Canadian IGA, including depository institutions, custodial institutions, and specified insurance companies. Using the FATF’s definition of “financial institution” to interpret the definition of “investment entity” under the Canadian IGA would be inconsistent with the language of the agreement and would result in classifying virtually every type of banking entity as an investment entity, thereby rendering the other subcategories of financial institution in the Canadian IGA superfluous.

Third, financial institutions under the FATF recommendations can be individual persons, whereas it is generally understood that financial institutions under FATCA and the IGAs must be entities. As noted above, an “entity” is defined by the Canadian IGA as “a legal person or a legal arrangement such as a trust.” A “legal person” is not defined in the Canadian IGA (or the Treasury regulations), but since the term “natural person” is used elsewhere in article 1, it is reasonable to conclude that an investment entity under the IGA cannot be an individual person. Furthermore, the Treasury regulations define the term “entity” to mean “any person other than an individual.”

Fourth, as regards the meaning of “financial institution” under the Canadian IGA, the FATF recommendations are mentioned only in the definition of “investment entity,” and do not otherwise modify the definition of “financial institution” or its offspring, including “custodial institution.” Yet the implementing legislation modifies the meaning of “financial institution,” and the modified definition applies to all four subcategories of financial institution referred to in the Canadian IGA.

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213 See the respective definitions in article 1(b), (i), and (k) of the Canadian IGA, ibid.
214 See the definition of “financial institution” in article 1(1)(g), ibid.
215 The FATF recommendations refer to individual persons as “natural persons,” without defining the latter term. However, the term “legal persons” is defined to mean entities other than natural persons, strongly suggesting that a “natural person” under the recommendations means a flesh-and-blood individual. See the FATF recommendations, supra note 20, at 116 and 119.
216 Treas. reg. section 1.1471-1(b)(39); Canadian IGA, supra note 1, articles 1(1)(g) through (k) and (gg); Model 1A IGA, supra note 10, articles 1(1)(g) through (k) and (gg).
217 Canadian IGA, supra note 1, article 1(1)(gg).
218 Ibid., articles 1(1)(v) and (mm).
219 Nor will a trust constitute an investment entity, according to the preamble in article 1(1)(j), if it is managed by an individual person. Note, however, that “entity” is not capitalized in the parenthetical phrase in the preamble, making it unclear whether that term refers to an “entity” as defined in article 1(1)(gg), and whether a trust must be managed by someone other than an individual person in order to constitute an investment entity under the Canadian IGA. See also Model 1A IGA, supra note 10, article 1(1)(j) (which contains the same inconsistency).
220 Treas. reg. section 1.1471-1(b)(35).
221 Canadian IGA, supra note 1, articles 1(1)(g) through (k).
222 See ITA subsection 263(2).
The Department of Finance presumably reads the FATF reference out of the definition of “investment entity” into the definition of “financial institution.” The FATF reference cannot be used to support the proposition that a personal trust is not a custodial institution. Consequently, the legislation is unsound (at least in this regard) and should be limited to investment entities.

Finally, a former Treasury official responsible for answering questions regarding FATCA disagrees with Canada’s interpretation of the FATF reference. Jesse Eggert, former Treasury associate international tax counsel, stated that managed trusts will be financial institutions subject to FATCA to the extent that they are managed by an FFI even if they would not be a financial institution under the FATF recommendations. Therefore, the FATF reference should not be used to support a more restrictive reading of “financial institution” under the Canadian implementing legislation.

Certain Personal Canadian Trusts Should Be Classified as Custodial Institutions Under the Canadian IGA

In addition to being classified as investment entities, personal Canadian trusts could be classified as custodial institutions and thus financial institutions. A “custodial institution” is defined as any entity

that holds, as a substantial portion of its business, financial assets for the account of others. An entity holds financial assets for the account of others as a substantial portion of its business if the entity’s gross income attributable to the holding of financial assets and related financial services equals or exceeds 20 percent of the entity’s gross income during a certain time period. Notably, the IRS initially took the position that foreign trusts are custodial institutions—and thus financial institutions—although the Treasury regulations subsequently precluded this position by significantly restricting the types of income constituting “income attributable to holding financial assets and related financial services,” which is a prerequisite for the trust to qualify as a custodial institution.

The Canadian IGA, however, does not contain the limitation in the Treasury regulations, and the Canadian implementing legislation does not provide an explicit option to apply the definitions in the regulations if they are more favourable under article 4(7) of the Canadian IGA. It is unclear whether the implementing legislation “permits Canadian financial institutions” to use a definition in the Treasury regulations.

223 Compare articles 1(1)(g) and (j) of the Canadian IGA, supra note 1.
224 Sheppard, supra note 198, at 1165.
225 Canadian IGA, supra note 1, article 1(1)(h).
226 Treas. reg. section 1.1471-5(e)(3)(ii); temp. Treas. reg. section 1.1471-5T(e)(3)(ii).
227 Canadian IGA, supra note 1, article 1(1)(h); IRS Notice 2010-60, supra note 51.
in lieu of a definition in the Canadian IGA. The preamble to the implementing legislation merely enacts the Canadian IGA to the extent that the legislation does not override the IGA, and the legislation is silent regarding the opportunity in article 4(7). Accordingly, unless Canada allows Canadian financial institutions this opportunity to opt out, many personal trusts should be classified as custodial institutions under the Canadian IGA, since trustees hold financial assets for others as a substantial portion of their business and the 20 percent threshold should be met for trusts holding primarily financial assets. Perhaps the CRA could further clarify the applicability of article 4(7) in its guidance notes on FATCA.

THE CANADIAN IMPLEMENTING LEGISLATION EXCLUDES PERSONAL CANADIAN TRUSTS FROM FATCA UNDER THE CANADIAN IGA

The Department of Finance excluded personal Canadian trusts from FATCA under the implementing legislation by restricting the Canadian IGA’s definition of “financial institution.” In a public comment, Finance indicated that it excluded personal trusts from FATCA under the Canadian IGA for administrative ease and was justified in doing so because of the FATF reference. Finance has a valid point: subjecting personal trusts to FATCA under the Canadian IGA would be administratively difficult, costly, and time-consuming for financial institutions. Moreover, if Finance feels justified in its position because of the FATF reference, it presumably believes that other jurisdictions that have concluded that personal trusts are subject to FATCA under their respective IGAs, such as the United Kingdom and Ireland, have unnecessarily expanded FATCA’s scope. As discussed above, Finance’s reliance on the FATF reference is misplaced.

From a practical perspective, by excluding personal Canadian trusts properly classified as financial institutions from the definition of “financial institution,” Finance

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228 Canadian IGA, supra note 1, article 4(7).
229 Canadian implementing legislation, supra note 2, paragraph 4 of the preamble.
230 See Cotorceanu, The First Nibble, supra note 199, at 417. “Financial asset” is not defined in the Canadian IGA; however, the Treasury regulations define the term to mean a security, partnership interest, commodity, insurance contract, annuity contract, or an interest in any of the foregoing. Treas. reg. section 1.1471-5(e)(4)(ii).
231 The CRAs guidance notes, supra note 19, at 2.3 and 2.4, mention this possibility but do not allow the opt-out unless the CRA permits it. It is unclear why the guidance notes contain this restriction. Also note that the guidance notes take a static view of the Treasury regulations, at least in part. See ibid., at 3.31 and 3.35.
232 See DiSpalatro, supra note 205, quote from an unnamed Department of Finance official.
233 Ibid.
234 Ibid.
235 See supra, the text accompanying notes 206-224.
has reduced, but not eliminated, their FATCA compliance burden. These personal Canadian trusts would probably still be classified as NFFEs subject to lower reporting thresholds, due diligence requirements, and withholding requirements under the Code and the Treasury regulations, even though they would not technically fall under the definition of an NFFE. That is, technically these trusts could not qualify as NFFEs since, by definition, an NFFE is a foreign entity that is not a financial institution.236 This definitional nicety would likely be overlooked by the IRS in practice, on the basis that these misclassified personal Canadian trusts are NFFEs if they are not financial institutions under the Canadian implementing legislation. After all, a trust resident in Canada is a foreign entity, and a foreign entity is subject to FATCA as either an FFI or an NFFE.

Although Finance’s intentions are understandable, its position that personal Canadian trusts should not be subject to FATCA under the Canadian IGA comes with serious consequences. This position also seems to discount the type of activity that FATCA seeks to prevent—tax evasion through offshore investments—and shows that Finance may not have fully understood FATCA’s unique withholding regime. Moreover, Finance may have underestimated the administrative burdens that its position imposes on non-Canadian financial institutions making withholdable payments to personal Canadian trusts and the transactional costs to these trusts from obtaining refunds on unnecessary FATCA withholdings.

Subsection 263(2) of the ITA237 narrows the definition of financial institution found in the Canadian IGA by restricting the definition to listed financial institutions. A listed financial institution does not include a personal Canadian trust that would otherwise be included as a financial institution under the Canadian IGA, as examined above.238 The 13 entities specified as listed financial institutions are generally banks, quasi-public entities regulated by Canadian law, and other entities (including trusts) represented or promoted to the public; personal Canadian trusts are not one of these entities.239 Notably, the implementing legislation applies to trusts that probably would not be classified as “trusts” under US tax law. These Canadian trusts, while taxed as trusts under Canadian law, would probably be business trusts or investment trusts and reclassified as corporations or partnerships for US tax purposes.240

Negotiations between the Department of Finance and the US Treasury are not on public record, and what was discussed is currently unknown. It is entirely possible that Finance and Treasury discussed and agreed to the restrictive definition of “financial institution” reflected in the implementing legislation. Assuming, however, that

236 IRC section 1472(d); Treas. reg. section 1.1471-1(b)(80).
237 Supra note 3.
238 See supra, the text accompanying notes 177-231.
239 See ITA subsection 263(1), the definition of “listed financial institution.”
240 Treas. reg. section 301.7701-4(b). See also Morrissey v. Commissioner, supra note 195.
there was no off-the-record agreement, Finance would be precluded from departure from the definition found in the Canadian IGA for the following reasons.

First, the Canadian IGA provides that any term not defined in it will, unless modified by the competent authorities, be determined under local law. Yet “financial institution” is already defined in the Canadian IGA. Second, the Canadian IGA provides that, notwithstanding the definitions in the IGA, Canada may elect to use the definitions found in the Treasury regulations provided that this use does not frustrate the purposes of the IGA. The restrictive interpretation of “financial institution” in ITA subsection 263(2) is not present in the Treasury regulations. Furthermore, when explaining the interaction between foreign law and the IGAs, an IRS official stated that although the IGAs will develop under foreign law, they are meant to be consistent with the Treasury regulations. Third, the Canadian IGA’s “most-favoured-nation” clause grants Canada the benefit of any more favourable terms under article 4 or annex I afforded to another jurisdiction with a similar IGA regarding the application of FATCA to its financial institutions. At the time of completion of this article, no other country with a signed IGA has restricted the definition of “financial institution” to specifically exempt personal trusts from FATCA under that IGA, as Canada has done in its implementing legislation. Notably, Canadian residents should be able to benefit from the most-favoured-nation clause since Canada has not explicitly elected out of it. Consequently, the implementing legislation initially appears to be incongruent with the Canadian IGA.

History of the Legislation—The Punctuation Error in the Draft Legislation and the CRA’s Guidance Notes

There was originally a punctuation error in draft subsection 263(2) that materially changed the meaning of the draft legislation, and probably would have prevented the inconsistent treatment of financial institutions under Canadian law. Subsection 263(2) corrected the punctuation error by adding a critical comma before the last clause:

(2) For the purposes of this Part, “Canadian financial institution” and “reporting Canadian financial institution” each have the meaning that would be assigned by the [Canadian IGA], and the definition “non-reporting Canadian financial institution” in

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241 Canadian IGA, supra note 1, article 1(2).
242 Ibid., article 1(1)(g).
243 Ibid., article 4(7).
244 Coder and Sheppard, supra note 114.
245 Canadian IGA, supra note 1, article 7(1).
246 See the FATCA archive, supra note 9.
247 IRS Notice 2014-33, supra note 58, at IV(B).
248 See supra note 18, the articles by Johnston and Melnitzer.
subsection (1) has the meaning that would be assigned by that subsection, if the definition “Financial Institution” in subparagraph 1(g) of Article 1 of the [IGA] were read as follows . . . .

Before the critical comma was added, the last clause modified only the definition of “non-reporting Canadian financial institution.” The definitions outlined in the preceding clause arguably should not be limited by the latter. After that critical comma, the last clause modifies every definition in the sentence, significantly restricting the class of financial institutions subject to FATCA under the legislation, and thus indirectly restricts the Canadian IGA’s definition of “financial institution” under Canadian law. The legislation also contains a new definition—“listed financial institution.” Although the new definition expands the list of entities subject to FATCA under Canadian law by 2 (bringing the total from 11 to 13),249 it will still exclude personal Canadian trusts from FATCA under the Canadian IGA.

The CRA’s recently released guidance notes on FATCA also demonstrate (among other things) Canada’s intent to restrict the Canadian IGA’s definition of “financial institution.”250 Example C states:

Peter establishes a Canadian resident trust as a vehicle to hold financial assets for family estate planning purposes in Canada. The trust is settled with capital provided by Peter and it is not represented or promoted to the public. The trust is not described in the definition of the term “listed financial institution” in subsection 263(1) of the ITA and is not a Canadian financial institution with due diligence and reporting obligations under Part XVIII.251

249 Compare ITA subsections 263(1) and (2) with subsection 263(2) of the draft legislation, supra note 2. These two new entities are entities “represented or promoted to the public” as various types of investment funds (such as hedge funds and venture capital funds) and clearing houses or clearing agencies: see subsection 263(1), the definition of “listed financial institution,” paragraphs (k) and (l). The legislation also adds the words “fund administration, or fund management” to paragraph (j) of the definition; this change is insignificant. Simultaneously, the legislation slightly decreases the scope of the legislation by limiting paragraph (j) to “an entity” (the draft legislation referred to “a person or an entity”). This change is also insignificant, given that FATCA applies only to entities, and not individuals. Treas. reg. section 1.1471-1(b)(39); Canadian IGA, supra note 1, articles 1(1)(g) through (k) and (gg).

250 See supra note 19, and the articles by Johnston and Melnitzer, supra note 18. The CRA is authorized to make regulations under the implementing legislation. Canadian implementing legislation, supra note 2, at paragraph 5 of the preamble.

251 CRA guidance notes, supra note 19, at chapter 3.27, example C.
This example is contrary to the Treasury regulations directly on point and the definition of financial institution under the Canadian IGA.\textsuperscript{252} Furthermore, the CRA's guidance notes contain a questionable rule regarding an unambiguous US place of birth, which states that the United States must be identified as the country of birth to be considered unambiguous.\textsuperscript{253} For example, if a US citizen presents a birth certificate showing Boston, Massachusetts as his or her place of birth when opening a new savings account at a reporting Canadian financial institution, the birth certificate is not an indicium of an unambiguous US place of birth and the institution is not required to report it under the guidance notes. This is truly problematic, since no birth certificate that we have seen identifies the United States as the country of birth. The infamous Holmesian “bad man”\textsuperscript{254} would have a field day with this rule, easily bypassing the Canadian legislation in direct contravention of the Canadian IGA’s purpose by providing a birth certificate rather than a US passport (which specifically identifies the bearer’s place of birth as, for example, “MASSACHUSETTS, U.S.A.” or simply “U.S.A.” if the passport was issued in Canada). The CRA’s guidance notes should not provide this escape hatch,\textsuperscript{255} and should be amended accordingly.

CONSEQUENCES OF RESTRICTING THE CLASS OF ENTITIES SUBJECT TO FATCA UNDER THE CANADIAN IMPLEMENTING LEGISLATION

FATCA belongs to a unique body of law, the enforcement of which does not rely on the action of any sovereign but rather on rational economic decisions made by market participants. The Code and Treasury regulations generally provide that before an entity subject to FATCA (“the payee”) transfers withholdable payments to the withholding agent (“the payer”), the payer must ascertain the status of the payee and determine whether FATCA withholding is required.\textsuperscript{256} The result is a definition of “financial institution” that is different in Canada, the United States, and other jurisdictions. This type of incongruity is what the OECD CRS warns against and seeks to prevent through its standardized reporting requirements.\textsuperscript{257}

Where both the payer and the payee are Canadian residents, there is a lower chance of confusion or unnecessary withholding because they are both subject to the Canadian implementing legislation. However, where the payer is not a Canadian resident, its decision to withhold becomes more complicated. Needless to say,

\textsuperscript{252} Treas. reg. section 1.1471-5(e)(4)(v), examples 5 and 6; Canadian IGA, supra note 1, article I(1)(g). See supra, the text accompanying notes 177-231.

\textsuperscript{253} CRA guidance notes, supra note 19, at 8.28.


\textsuperscript{255} See Canadian IGA, supra note 1, annex I(II)(B)(4).

\textsuperscript{256} IRC sections 1471(a), 1472(a), and 1473(1)(A); Treas. reg. section 1.1471-3. See also Treas. reg. sections 1.1471-1(b)(96) and (140), and 3(a); temp. Treas. reg. section 1.1471-1T(b)(98).

\textsuperscript{257} OECD CRS, supra note 43, at 7-8.
entities that are not Canadian residents are not bound by Canada’s implementing legislation regarding FATCA. Under the general rules, if a payer does not withhold when required, it is personally liable for the withholding and any applicable interest and penalties.\(^{258}\) Accordingly, a payer that is uncertain of the FATCA status\(^{259}\) of an entity such as a personal Canadian trust—because, for example, Canadian law limits the class of entities subject to FATCA—will likely withhold (absent explicit IRS guidance to the contrary) because to do otherwise would expose the payer to liability for the non-withheld amount.\(^{260}\) In such cases, the payer may prefer to deal with a disgruntled customer than an IRS agent asking for FATCA withholding that the payer failed to collect. However, such withholding would be undesirable for Canadian cross-border investors, who would be subject to unnecessary compliance burdens and costs from obtaining the refunds of the excess withholdings.

Additionally, the implementing legislation may have much more dire consequences for Canadians by jeopardizing the Canadian IGA’s status. The United States may see the legislation as an invalid implementation of the agreement, potentially precluding it from entering into force.

**Restricting the Definition of Financial Institution Could Lead to Unnecessary Overwithholding**

Before making a payment subject to FATCA, a payer must determine the identity and status of the payee under FATCA, and the payee must establish its status by providing substantiating documentation.\(^{261}\) Personal Canadian trusts would presumably take the position that they are either (1) non-financial institutions exempt from FATCA under the Canadian implementing legislation or (2) NFFEs, and must provide a certificate to the payer to that effect,\(^{262}\) using IRS form W-8BEN-E.\(^{263}\) We will discuss these possible reporting positions below, after summarizing some general rules. For the purposes of the discussion immediately below, personal Canadian trusts analyzed under the withholding rules are assumed to be entities properly classified as financial institutions under the Canadian IGA but misclassified as non-financial institutions under the Canadian implementing legislation.

**General Rules for Determining a Payee’s FATCA Status**

The payer can rely on documentation provided by a payee to establish the payee’s FATCA status unless the payer knows or has reason to know that the information

\(^{258}\) IRC section 1474(a); Treas. reg. section 1.1474-1; temp. Treas. reg. section 1.1471-3T(f)(9)(i).

\(^{259}\) Or “chapter 4 status,” as the Treasury regulations christen it. Treas. reg. section 1.1471-3(b).

\(^{260}\) IRC sections 1471(a) and 1474(a); Treas. reg. sections 1.1471-3(d) and (d)(12).

\(^{261}\) Canadian IGA, supra note 1, annex I(IV)(D)(4); Treas. reg. section 1471-3(b).

\(^{262}\) Canadian IGA, supra note 1, annex I(IV)(D)(4), (V)(B), and (VI)(B)(2); Treas. reg. sections 1.1471-3(d) and (d)(12); IRC sections 1472(a) and (b); Treas. reg. section 1.1472-1(a).

\(^{263}\) Supra note 78.
provided is incorrect or receives notice from the IRS that the payee’s claim of status is incorrect.264 In the case of a personal Canadian trust, the problem is that under the Code, the Treasury regulations, and the Canadian IGA, the trust is probably not an NFFE, but an FFI subject to FATCA under the IGA. That is, many personal Canadian trusts are properly classified as financial institutions under the Canadian IGA, but misclassified as non-financial institutions under the Canadian implementing legislation.

Under the Treasury regulations, if a payee’s claimed FATCA status conflicts with the payer’s documentation, the payer must presume that the payee is a non-participating FFI and withhold.265 For example, if a personal Canadian trust’s claim of status conflicts with any information in the payer’s files, including documentation collected by its anti-money-laundering due diligence procedures, the payer will be considered to have reason to know that the trust’s claim is unreliable, and must withhold or be held personally liable for the withholding.266 Moreover, under the Canadian IGA, reporting Canadian financial institutions—which include personal Canadian trusts properly classified as financial institutions—cannot rely on self-certifications or documentary evidence if they know or have reason to know that the certification or evidence is incorrect or unreliable, and they must withhold, absent an exception to the contrary.267

Furthermore, the Code makes the decision to withhold in this situation easier since it explicitly indemnifies the payer against claims and demands of any person for required FATCA withholding.268 Where a payer withholds on the basis of a reasonable belief that withholding is required, the payer is treated as if withholding were required for indemnification purposes.269 There are no penalties under FATCA for overwithholding,270 and the payer may—but is not required to—reimburse the payee for amounts that were overwithheld, or use these amounts to set off taxes otherwise required to be paid.271

264 Canadian IGA, supra note 1, annex I(VI)(A); Treas. reg. sections 1471-3(d) and (e); temp. Treas. reg. section 1.1471-3T(e)(4) (which provides the standards for “reason to know”).
265 Temp. Treas. reg. sections 1.1471-3T(f)(4) and (9).
266 Temp. Treas. reg. section 1.1471-3T(e)(4); Treas. reg. section 1.1471-3(e)(1).
267 Canadian IGA, supra note 1, annex I(VI)(A); Treas. reg. section 1.1474-1; temp. Treas. reg. section 1.1471-3T(f)(9)(i).
269 Treas. reg. section 1.1474-1(f).
270 However, the payer may be subject to suit by the payee if its decision to withhold was unreasonable. Ibid. It is questionable, however, whether a payee would actually sue the payer when it can claim a refund from the IRS instead. See Dale, supra note 268, at 95-100.
The combination of these rules—personal liability for FATCA withholding, indemnification, lack of penalties for overwithholding, and the absence of a requirement to reimburse or set off overwithheld amounts—makes withholding the safest (and thus the default) choice whenever the payer is in doubt. The only check on this behaviour would be the economic consequences of a payer’s policy to overwithhold. When the dust settles, payees that are subject to overwithholding will most likely be left in the unenviable position of applying directly to the IRS for a refund of the overwithheld amount.\textsuperscript{272}

Eventually, these misclassified Canadian payees will be reported to the IRS under the Treasury regulations or another IGA,\textsuperscript{273} and the IRS may apply the procedures in article 5 or 8 of the IGA—or, worse, terminate the IGA.\textsuperscript{274} Interestingly, Canada would be required to apply its domestic law, including applicable penalties, to address any significant non-compliance identified.\textsuperscript{275}

While a discordance of entity classification on form W-8BEN-E would result in the unnecessary withholding described above, the IRS could craft a solution to mitigate this result. Unnecessary withholding occurs when a payee’s claimed status is different from what the payer knows or has reason to know it should be. It might be possible for the IRS to clarify form W-8BEN-E to acknowledge that the entity’s status may be different under its domestic legislation than it would be under FATCA proper. That is, such an entity would effectively be reclassified as an NFFE under the applicable domestic implementing legislation. As a result, there would be no difference in classification on the form itself, and withholding would presumably be unnecessary. If the IRS allowed this result, it would be confirmation that IGA partner jurisdictions will truly be able to enact legislation that works domestically, in accordance with the spirit of the IGAs. Otherwise, arguably all IGA partner implementing legislation must, in essence, be US law packaged with a foreign-law label. Yet, these possible revisions to form W-8BEN-E may also signal to IGA partner jurisdictions that they may unilaterally change important definitions to effectively exempt certain entities from the more onerous FATCA obligations as financial institutions, by reclassifying them as NFFEs under their domestic law. Notably, without these possible revisions to form W-8BEN-E, payees that improperly certify that they are entities other than financial institutions may face criminal prosecution, since that form is signed under penalties of perjury.\textsuperscript{276}

\textsuperscript{272} Treas. reg. sections 1.1471-4(h)(4) and 1.1474-5.
\textsuperscript{273} Treas. reg. section 1.1471-4(c); Model 1A IGA, supra note 10, article 4(1).
\textsuperscript{274} Canadian IGA, supra note 1, article 10(2).
\textsuperscript{275} Ibid., article 5(2)(b).
\textsuperscript{276} See, for example, IRC section 7206(1); 18 USC section 1001.
Non-Financial Institutions Exempt from FATCA
Under the Canadian Implementing Legislation:
Delayed or Immediate Withholding

Where a personal Canadian trust is properly classified as a financial institution under the Canadian IGA but misclassified as a non-financial institution under the Canadian implementing legislation, and the trust fails to register with the IRS as required under article 4(1), it will face FATCA withholding; the only question is when that withholding will occur. Generally, we assume that the trust would provide withholding certificates or other documentation stating that it is a non-financial institution not subject to FATCA—though this is a hard position to defend, given that a personal Canadian trust is an entity and, as such, must be either an FFI or an NFFE.277 There are three ways to analyze this issue for such trusts: first, under the Canadian IGA in isolation; second, under the Treasury regulations in isolation; and third, under the Canadian IGA together with the Treasury regulations.

Recall that article 4(1) of the Canadian IGA provides, in the postamble, that reporting Canadian financial institutions that do not comply with the requirements of articles 4(1)(a) through (e) are exempt from FATCA withholding unless the IRS treats them as a non-participating financial institution under article 5(2)(b). Consequently, a reporting Canadian financial institution’s non-compliance must be substantial, and must exceed 18 months before withholding can be imposed under the Canadian IGA.278 There are no similar provisions in either the Code or the relevant Treasury regulations.279

The Treasury regulations suggest that any reporting Canadian financial institution (or any reporting Model 1 FFI) that fails to obtain a GIIN is disallowed the benefit of article 4(1)’s protection from FATCA withholding.280 Specifically, the temporary Treasury regulations provide281 that the payer must withhold on withholdable payments to FFIs unless either

1. the payment is made under a grandfathered obligation in Treas. reg. section 1.1471-2(b) or is proceeds from the disposition of a grandfathered obligation; or
2. the payer can reliably associate the payment with permissible documentation to treat the payment as exempt from FATCA withholding under Treas. reg. section 1.1471-2(a)(4).

277 IRC sections 1471(a) and 1472(d).
278 Canadian IGA, supra note 1, article 5(2)(b).
279 See Treas. reg. sections 1.1471-2(a)(1) and (4); temp. Treas. reg. sections 1.1471-2T(a)(1) and (4).
280 Treas. reg. section 1.1471-5(f)(1).
281 Temp. Treas. reg. section 1.1471-2T(a)(1).
For the purposes of this analysis, we will assume that withholdable payments are not made under a grandfathered obligation, which is generally an obligation outstanding on July 1, 2014.\footnote{Treas. reg. section 1.1471-2(b)(2)(i); temp. Treas. reg. section 1.1471-2T(b)(2)(i)(A)(1).} Withholdable payments are exempt from FATCA withholding under various circumstances in Treas. reg. section 1.1471-2(a)(4), the most relevant of which are the following:\footnote{Treas. reg. sections 1.1471-2(a)(4)(ii) through (iv); temp. Treas. reg. section 1.1471-2T(a)(4)(ii).}

- withholding on payments made before July 1, 2016 for pre-existing obligations of a non-prima facie FFI;
- payments to participating FFIs; and
- payments to deemed-compliant FFIs.

We will also assume that withholdable payments are not made on a pre-existing obligation, which is generally an account, instrument, contract, debt, or equity interest outstanding on June 30, 2014.\footnote{Temp. Treas. reg. section 1.1471-1T(b)(104)(i).} Personal Canadian trusts that are financial institutions under the Canadian IGA are not participating FFIs. A participating FFI is an FFI that agreed to an FFI agreement (including an FFI described in a Model 2 IGA) and a qualified intermediate branch of a US financial institution unless the branch is a Model 1 FFI.\footnote{Temp. Treas. reg. section 1.1471-1T(b)(91).} Personal Canadian trusts do not fall under this definition because they will not have FFI agreements under the IGA and are not US financial institutions, but are Canadian financial institutions.\footnote{Treas. reg. sections 1.1471-1(b)(109) and (136).}

For payments made after January 1, 2015, personal Canadian trusts that do not properly register with the IRS and obtain a GIIN should not qualify as deemed-compliant FFIs because of how that term is defined. Reporting Canadian financial institutions cannot qualify as deemed-compliant FFIs unless they have a GIIN.\footnote{Treas. reg. section 1.1471-5(f)(1).} Yet a personal trust will be exempted from withholding for payments made before January 1, 2015—whether or not it has a GIIN—if it provides a certificate (that is, form W-8BEN-E) to the payer indicating that the trust is a reporting Canadian financial institution under the Canadian IGA.\footnote{Temp. Treas. reg. section 1.1471-3T(d)(4)(iv)(A).} Accordingly, a personal Canadian trust that is a financial institution under the Canadian IGA could delay the inevitable withholding and IRS registration requirement until January 1, 2015 merely by indicating on a withholding certificate that it is a reporting Canadian financial institution.

Thus, the discordance between the Canadian IGA and the Treasury regulations creates uncertainty regarding the applicability of the postamble of article 4(1) for reporting Canadian financial institutions that fail to comply with the listed requirements in that article, particularly the requirement to register with the IRS and obtain
a GIIN. This uncertainty means that it is unclear when FATCA withholding will begin: starting 18 months after July 1, 2014; on January 1, 2015; or immediately. Specifically, personal Canadian trusts that are financial institutions under the Canadian IGA but misclassified as non-financial institutions under the Canadian implementing legislation, and that do not comply with their FATCA requirements, will face withholding; it is merely a question of when that withholding must occur under the applicable rules, and which rule the withholding agent (the payer) decides to follow. If the payer examines the Canadian IGA in isolation, it must wait over 18 months before withholding is required under article 5(2)(b). If the payer examines the Treasury regulations in isolation, it must withhold on withholdable payments made starting either on July 1, 2014 (FATCA’s effective date)\textsuperscript{289} or on January 1, 2015 if (contrary to our assumption above) the personal Canadian trust certifies that it is a financial institution. Finally, if the payer examines the Canadian IGA together with the Treasury regulations, it is unclear when withholding must occur, and the payer may choose to withhold in order to avoid personal liability for withholding otherwise required.\textsuperscript{290} Whether payers are aware of this quandary or not, many will likely withhold immediately rather than face personal liability for the FATCA withholding that may be required.

\textbf{NFFEs: Immediate Withholding Unless an Exception Applies}

Although personal Canadian trusts properly classified as financial institutions under the Canadian IGA but misclassified as non-financial institutions under the implementing legislation cannot qualify as NFFEs because, by definition, they are FFIs, when asked about their FATCA status, some may choose to certify that they are NFFEs on form W-8BEN-E rather than claim that they are non-financial institutions not subject to FATCA. Regardless of definitional niceties, these trusts remain entities under FATCA, and entities are either FFIs or NFFEs. Claiming status as a non-financial institution not subject to FATCA under the implementing legislation is currently not an option on form W-8BEN-E. Moreover, if a dispute arose, the IRS would certainly argue that these misclassified trusts are NFFEs as its secondary position (that is, if it lost the argument that they were FFIs).

Misclassified personal Canadian trusts certifying that they are NFFEs will be subject to FATCA withholding on withholdable payments unless they report information regarding the accounts and other ownership interests of US persons.\textsuperscript{291} This general withholding rule will require withholding on payments to misclassified personal Canadian trusts, unless they fulfill their truncated FATCA obligations as NFFEs (as compared with the more robust FATCA obligations for FFIs). There are two potential notable exceptions to the general rule. First, there is a transitory exception

\begin{itemize}
  \item \textsuperscript{289} IRS Notice 2013-43, supra note 51.
  \item \textsuperscript{290} IRC section 1474(a); Treas. reg. section 1.1474-1; temp. Treas. reg. section 1.1471-3T(f)(9)(i).
  \item \textsuperscript{291} IRC section 1473(1)(A); Treas. reg. section 1.1472-1(a).
\end{itemize}
to the general rule for withholdable payments made before January 1, 2016 in the Treasury regulations if\textsuperscript{292}

1. the payment is on pre-existing obligations of a non-prima facie FFI payee; and
2. the documentation required to determine FATCA status does not indicate that the payee is a passive NFFE when the payee has not provided the required owner certification.

If both of these requirements are met, the payer is not required to withhold or report on payments to NFFEs.\textsuperscript{293} Second, FATCA withholding is not required for withholdable payments made to excepted NFFEs, the most relevant of which includes active NFFEs.\textsuperscript{294} An active NFFE must meet both of the following tests:\textsuperscript{295}

1. \textit{Passive income test}: Less than 50 percent of the gross income from the past tax year is passive income.
2. \textit{Passive assets test}: Less than 50 percent of the weighted average of its assets held during the past tax year are assets held for the production of passive income.

Thus, misclassified personal Canadian trusts that are NFFEs will be subject to FATCA withholding on withholdable payments made starting July 1, 2014 unless they fulfill their FATCA requirements or fall under one of the exceptions listed above.

\textbf{Restricting the Definition of Financial Institution May Invalidate the Canadian IGA}

Alternatively, in the worst-case scenario, the United States may view the legislation as an invalid implementation of the Canadian IGA under article 10(1), thereby preventing the Canadian IGA from entering into force. If so, Canadians would be subject to the more stringent default rules under the Code and the Treasury regulations, where the withholding regime is much less forgiving and FFIs must enter into FFI agreements to report directly to the IRS.\textsuperscript{296} Canadian financial institutions would then be faced with the dilemma of choosing between following Canadian law, and

\begin{itemize}
\item \textsuperscript{292} Temp. Treas. reg. section 1.1472-1T(b)(2).
\item \textsuperscript{293} Ibid.
\item \textsuperscript{294} Temp. Treas. reg. section 1.1472-1T(c)(1).
\item \textsuperscript{295} Temp. Treas. reg. section 1.1472-1T(c)(1)(iv). See Canadian IGA, supra note 1, annex I(VI)(B)(2).
\item \textsuperscript{296} Compare Canadian IGA, supra note 1, articles 4(1) and 5(2) with Treas. reg. sections 1.1471-4 and 1.1472-1.
\end{itemize}
suffering the consequences under FATCA, or following the default rules under the Code and Treasury regulations, and suffering the consequences under Canadian law. This is an unlikely alternative, since the United States or Canada could invoke article 8 of the Canadian IGA and request a consultation to resolve the differences between the Canadian legislation and the IGA.

Finally, the United States may treat the legislation as Canada’s abrogation of its obligations under articles 2 and 3 of the Canadian IGA, thereby precluding all entities with inconsistent FATCA classifications under the legislation—such as personal trusts—from being treated as FATCA-compliant and subjecting them to withholding.297 Reporting Canadian financial institutions would then again be subject to the default rules under the Code and the Treasury regulations.

**CONCLUSION**

The Canadian implementing legislation places Canada either in the vanguard of legislative drafting regarding FATCA or as discrepant with the United States and other jurisdictions with IGAs. As shown above, we believe the latter is true.

FATCA is an ambitious, complex, and dynamic regime for eliminating tax evasion and perceived abuses through offshore investments and entities. As demonstrated by the OECD CRS, FATCA is quickly becoming the new global standard for the automatic exchange of information to combat these evils.298 FATCA does not have to be a one-sided affair. Canada and the rest of the world can benefit from standardized information exchange and changes to the international financial community to combat their own offshore tax evaders. Yet, to function effectively, the benefits of standardization that FATCA provides must be permitted to work without the possible impediments that the Canadian implementing legislation embodies. Simply, FATCA’s definitions and application will lack symmetry and consistency under the Canadian implementing legislation, which appears to demonstrate the antithesis of standardization regarding the classification of entities subject to its regime. Without the benefits of standardization, tax evaders will seek out and exploit jurisdictional inconsistencies to avoid FATCA. Therefore, we believe that the implementing legislation should be amended to facilitate FATCA’s effective implementation in Canada, ease FATCA’s burden on Canadians, and mitigate the negative consequences identified above.

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297 Canadian IGA, supra note 1, article 4(1).
298 OECD CRS, supra note 43. See Blank and Mason, supra note 32.