

Planning Matters

FATCA - How this U.S. Law Affects You

In early 2010 the U.S. government passed the Foreign Account Tax Compliance Act, or FATCA. The Internal Revenue Service (IRS) has stated FATCA “targets non-compliance of U.S. taxpayers using foreign accounts and establishes a global approach to combatting offshore tax evasion.” What that really means is the IRS is targeting “U.S. Persons” who have accounts outside American borders to avoid paying U.S. taxes. By some estimates there are upwards of \$100 billion annually in unpaid U.S. taxes on the worldwide income of U.S. Persons. Given the state of the economy, the U.S. government is very eager to start collecting these tax revenues.

The IRS will realize these extra tax revenues under FATCA by requiring foreign financial institutions (which includes investment management firms) to determine for accounts with more than \$50,000 which of their clients are “U.S. Persons,” document and track them over time, and report the identity and details of their account holdings to the IRS. Critics have described this as an instance of U.S. law forcing Canadian financial institutions to act as the IRS’s deputy.

Rather than having Canadian financial institutions report directly to the U.S. – an area of concern under Canadian privacy laws - the Canadian government is currently preparing its own version of FATCA and is negotiating an intergovernmental agreement with our neighbours to the South. This agreement will result in the CRA collecting the relevant personal account information from Canadian financial institutions and

forwarding it to the IRS. The Canadian government believes such an agreement will help to avoid breaking Canadian privacy laws.

So, what is a “U.S. Person” and who is affected by FATCA? Under U.S. tax law, you are a U.S. Person if you are:

- A citizen of the U.S. (including someone born in the U.S. but living in Canada who has not renounced their U.S. citizenship)
- A lawful resident of the U.S. (including a U.S. green card holder)
- A person residing in the U.S.
- A U.S. corporation, estate, or trust
- Someone spending a specified amount of time in the U.S. (possibly including Snowbirds)

If you are one of the approximately one million U.S. Persons who live in Canada, you are already required to file a U.S. tax return reporting your world-wide income. You are also subject to several information reporting obligations. Under FATCA there will be even more information filing requirements for you, and new requirements for your Canadian financial institution. They will be required to ask for more information than previously to determine if you are a U.S. Person. If you refuse any requests for information or documentation, under FATCA, you are deemed to be a U.S. Person and will be subject to the 30% withholding tax on your U.S. sourced income.

Of course, if you are a U.S. Person and were not filing your U.S. taxes, this is where FATCA impacts you the most. Since Canadian financial institutions will be required to help the IRS identify U.S. Persons and their foreign investments, it will become a lot more dangerous for U.S. Persons with investments in Canada to not report their Canadian-based income.

What if you are a Canadian and not a U.S. Person? You will find that FATCA has less impact on you, but you will still be affected.

Upon opening an account, your financial institution will be asking you additional questions to determine whether or not you are a U.S. Person. If you are an existing client, eventually your financial institution will perform due diligence on your account to determine if you are a U.S. Person. If there is any indication of your being a U.S. Person, you may be asked to provide additional information or documentation. Finally, as mentioned above, even if you are not a U.S. Person, should you refuse to provide such documents or

information under FATCA you will be deemed to be a U.S. Person. As a result, your Canadian financial institution will be forced to withhold and send to the IRS 30% of any U.S. payment received by your account. You might also find that you are prevented from opening any new accounts or even forced to close existing accounts.

Implementation of FATCA has been delayed many times. Most recently its implementation has been delayed until July 1, 2014. In addition, the full extent of its actual regulatory requirements will not be known until the Canada/U.S. intergovernmental agreement is finalized – possibly by this Fall. Nevertheless, FATCA is coming to Canada in the near future.

Summary:

If you are a high net worth U.S. Person living in Canada you need to understand FATCA's complex regulations. The complexity is such that even U.S. Persons who wish to comply may inadvertently fail to comply. Failure to comply could lead to costly penalties and/or criminal indictment. For U.S. Persons in Canada, consulting with your tax advisor is your best course of action. If you are a Canadian, you are going to find little has changed for you as a result of FATCA. You may be one of the Canadians asked to provide additional documentation to prove you are not a U.S. Person. However, as long as you comply, you will not be caught by the FATCA net. It is only if you choose to not provide the additional information or documentation where you could be subject to the withholding provisions of FATCA – a result best avoided.

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