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U.S. Clients

Understanding the Foreign Account Tax Compliance Act

If you deal with American clients, they may already be aware of their annual U.S. tax filing obligations. The United States is the only country that requires its citizens to file a tax return and report their worldwide income, no matter where in the world they might live or how many other citizenships they might hold. This differs from most other countries, like Canada, which base their taxation systems primarily on residency.

If your clients haven't been filing, they should strongly consider coming clean under the Internal Revenue Service's streamlined filing compliance procedures for non-resident U.S. taxpayers that became effective on Sept. 1, 2012. These new procedures are for non-residents including, but not limited to, dual citizens who have not filed U.S. income tax and information returns, and are designed for taxpayers that present, in the IRS's words, a "low compliance risk."

Taxpayers who don't qualify for the streamlined procedure may wish to consider the "Offshore Voluntary Disclosure Program (OVDP)," which was launched in January 2012. Under the OVDP, the IRS is offering people with undisclosed income from offshore accounts another opportunity to get caught up with their filing obligations. As the IRS states, "The 2012 OVDP … offers clear benefits to encourage taxpayers to disclose foreign accounts now rather than risk detection by the IRS and possible criminal prosecution."

The chances of being detected may soon be higher as a result of the Foreign Account Tax Compliance Act (FATCA), which is scheduled to be implemented on July 1, 2014. The goal of the FATCA legislation is to deter and prevent tax evasion among "U.S. persons" who maintain "financial accounts" outside the United States.

At the time of writing, nine countries (Denmark, Germany, Ireland, Japan, Mexico, Norway, Spain, Switzerland, and the United Kingdom) have established intergovernmental agreements (IGAs) with the U.S., and over 50 countries, including Canada, are negotiating IGAs.

Under the terms of this anticipated IGA, which is expected to be finalized by July 1, 2014, Canadian financial institutions will report the information directly to the Canada Revenue Agency (CRA) rather than to the IRS. As a result, starting in July 2014, banks and other financial institutions will be required to identify clients who are American and report certain account information to the CRA.

THE TAKE-AWAY

Starting in July 2014, Canadian banks and other financial institutions will be required to identify clients who are American and report certain account information to the CRA.

The penalties for not complying with FATCA can be severe — both for the financial institution and the client — and can include a 30 per cent withholding tax on all U.S. source income, as well as a 30 per cent withholding tax on the gross proceeds received on the sale of U.S. securities.

WHO IS A U.S. PERSON?

Under U.S. tax law, you are considered a "U.S. Person" if you are a: U.S. citizen, even if you live in Canada; a permanent resident of the U.S., generally including a U.S. green card holder; or a U.S. corporation, estate or trust.

Snowbirds who spend a significant amount of time in the U.S. annually may meet the substantial presence test and may also be considered a U.S. person for tax purposes.

WHICH "FINANCIAL ACCOUNTS" WILL BE REPORTABLE?

It's expected that most bank accounts, mutual funds, segregated fund contracts, brokerage and other custodial accounts will be reportable if the value of the account or contract is over $50,000. Permanent life insurance policies, like universal and whole life policies, that have a cash value greater than $50,000, as well as annuity contracts, would also be reportable.

Other insurance products that provide "pure" insurance protection and have no cash value, such as term life, disability insurance, health insurance and property and casualty insurance, would not be reportable.

In addition, various government registered retirement and savings plans (such as RRSPs, RRIFs, RPPs and the recently introduced PRPPs) are all expected to be exempt under the terms of the agreement.

LOBBYING EFFORTS

Many lobby groups, including the Canadian Bankers Association (CBA), the Canadian Life and Health Insurance Association (CLHIA), the Investment Funds Institute of Canada (IFIC), and the Investment Industry Association of Canada (IIAC) have raised concerns about FATCA, including a lack of necessary client documentation, privacy issues and withholding problems, as well as the enormous compliance cost with both the IRS and the U.S. Treasury Department. These groups continue to lobby the U.S. government to reduce the impact FATCA will impose on both financial institutions and your clients.

Despite such lobbying efforts, it looks like FATCA is coming, and it would be wise for those of your clients who are U.S. citizens to seek independent legal and U.S. tax advice to ensure they meet their U.S. filing obligations, preferably by the July 1, 2014, implementation date.

For more information on the impact of FATCA you may wish to direct clients to the CLHIA's excellent information sheet and Frequently Asked Questions, entitled "Information for Clients on the Canada-U.S. Information Exchange Agreement to Improve Cross-Border Tax Compliance," which can be found on the CLHIA's website.

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