



# Letter from the President

## U.S. FATCA Legislation: Paring Back the Tax-Reporting Burden

### Introduction: Preventing Tax Enforcement From Becoming An Unnecessary Burden

The Foreign Account Tax Compliance Act (FATCA) is a good example of a valid governmental goal that threatened to burden Canadian financial institutions – and their clients – with unnecessary cost and complexity.

Fortunately, through the work of the Investment Industry Association and others, much of the potential damage has been averted. While the changes will still add significant administrative burdens for firms, after two years of discussions between the financial industry, international governments and U.S. officials, Washington has been amenable to consult widely and work toward the application of practical principles that will at least ease the burden on firms.

### There has been progress on three fronts:

- The U.S. Treasury has shown an openness to rely on foreign tax authorities to gather information, streamlining the reporting burden on financial institutions.

- Greater reliance on existing procedures, such as anti-money laundering and know-your-client, may reduce documentation burdens, at least to some extent.
- Significant reporting burdens will also be eased through specific carve-outs.

While the FATCA legislation will still remain an additional administrative burden for firms – something we could all do without – the process has generated significant improvements that will ease the burden on the Canadian industry.

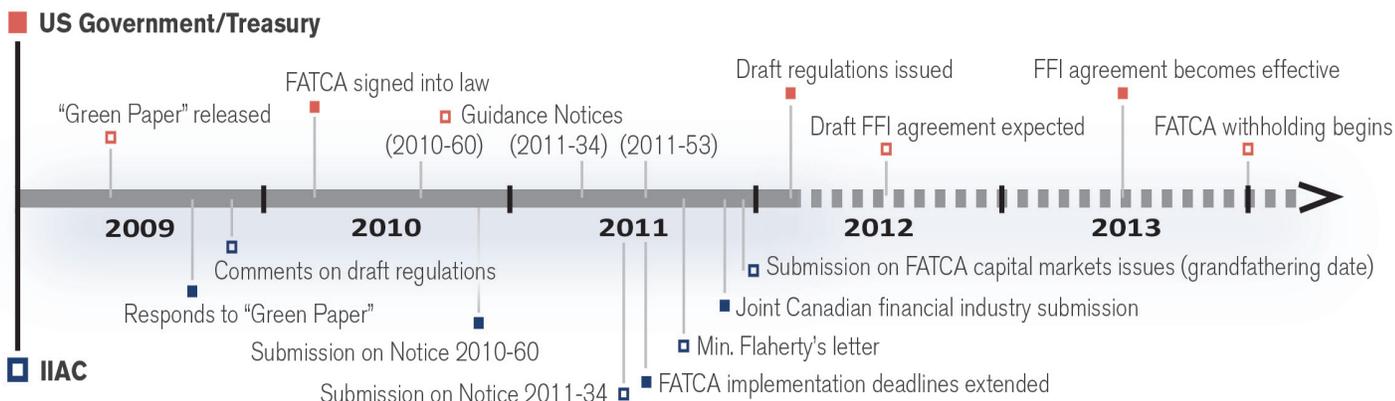
### Background: How the Legislation Emerged

It is worth going over the history of the issue. In the wake of the well-publicized UBS tax evasion case and subsequent settlement in 2009, the U.S. Treasury proposed sweeping proposals for U.S. resident tax-reporting involving foreign financial institutions.

While the proposals were ostensibly to improve disclosure and transparency of the tax reporting process, they were actually



### Moving Forward with the FATCA Regulations



aimed at detecting tax evasion among U.S. persons (including U.S. citizens and green-card holders) holding accounts at foreign financial institutions. The leverage for compliance was the threat of withholding on all U.S. income, including dividends and interest at source on client investments in U.S. securities.

IIAC initiated discussions with U.S. Congressional policymakers in 2009 as soon as preliminary legislative proposal, referred to as the "Green Paper", was released for comment. The FATCA legislation was eventually passed in early 2010. Throughout 2010-2011 the U.S. Treasury engaged in extensive consultations with financial institutions in foreign jurisdictions centered around three successive versions of "Guidance Notices" to the new legislation, with the objective of comprehensive fiscal regulations implementing FATCA in place by the end of 2012.

### **Curbing Tax Evasion vs. Limiting Burdens on Firms**

While IIAC acknowledged from the outset the right of U.S. authorities to take appropriate steps to minimize tax evasion by U.S. taxpayers, we stressed the need to balance this objective against limiting the burden and complexity of tax-reporting obligations on foreign institutions. We also emphasized the importance of a targeted, precise approach: The goal should be to identify the likely incidence of tax avoidance, and focus tax-reporting obligations on foreign tax havens and certain taxpayer categories. In this vein the Canadian Finance Minister Jim Flaherty went public last September, referring to the blunt and insensitive policy approach of the proposed legislation, sweeping up many Canadians with ties to the U.S. who had no knowledge of possible U.S. tax-reporting obligations, a situation causing unnecessary stress and aggravation.

### **Another Burden for the Canadian Securities Industry**

The FATCA requirements will be a costly burden for all investment dealers – who are already coping with the added regulatory burden of best execution requirements in equity markets that integrate ATSS and stock exchanges, and the coming Client Relationship Model that will demand increased client disclosure and enhanced suitability standards. This heavy regulatory burden coincides with difficult conditions in capital markets, and reduced investor and issuer participation that has squeezed margins and revenues. The FATCA requirements will not just impact large firms, but small introducer firms that will likely pay higher costs to carrying brokers for complying with the client tax reporting requirements. Moreover, the FATCA legislation as written may require introducer firms to file tax information directly with the U.S. Treasury.

### **New Draft FATCA Regulations**

On February 9 the U.S. Treasury released the first draft of FATCA regulations for comment. For the most part the U.S. authorities have taken a reasonable approach, in terms of the due diligence requirements and the extended implementation delays and "grandfathering dates", to allow further consultation and modification to the rules. The centerpiece of the regulations is the intergovernmental approach wherein the U.S. Treasury would rely on foreign tax authorities to obtain the required information on U.S. account holders. This approach, advocated by IIAC, would alleviate the compliance burden for individual financial institutions as they would not be required to enter into direct FATCA agreements with the IRS, and could comply with FATCA reporting requirements through existing channels with the domestic tax authority and leveraging existing tax treaties with the U.S. Moreover, the conveyance of client information to the domestic government would enable foreign financial firms to comply with relevant privacy legislation.

The Treasury announced that an intention to enter into intergovernmental agreements with the U.K., Germany, France, Spain and Italy, and have indicated their intent to explore this approach with other countries. We are optimistic Canada will join this arrangement -- for several reasons. First, a long-standing tax information sharing arrangement between the IRS and Canada Revenue Agency already exists, making it likely the two countries will build on this arrangement. Second, there are ongoing discussions between the authorities in both countries.

The intergovernmental tax reporting arrangements will still require foreign financial institutions to meet the due diligence standards for tax reporting under the FATCA legislation. Moreover, these intergovernmental arrangements may introduce some reporting challenges for trans-national financial institutions. However, the draft regulations have attempted to alleviate the reporting burden, at least to some extent, through reliance on existing practices for anti-money laundering compliance and common regulatory standards for know your client rules. Further, the draft regulations will provide important carve-outs that will ease the reporting obligation. Foreign institutions will limit the mandated due diligence process to individual accounts with outstanding amounts over \$1 million. As well, the regulations indicate an intention to exclude registered or tax-assisted accounts (accounts at low risk for tax evasion) will be excluded from the reporting requirements. In future consultations, IIAC will seek confirmation that all Canadian registered accounts, including RRSPs, RRIFs, TSFAs, RDSPs and RESPs, will be covered under exemptions in the FATCA regulations.



The draft regulations have pushed out the implementation date -- or the "grandfathering date" -- nearly a year, to January 2013, for complex financial transactions such as OTC derivative securities. This will give time to resolve the complications for the OTC derivative markets. Under the current regulatory framework, firms would be required to make amendments to formal swap and repo/securities lending agreements making reference to the specific conditions for withholding under the FATCA legislation, and would be required to renegotiate corresponding terms on existing transactions. This could cause significant disruption in global OTC markets, and heavy administrative costs for financial institutions, in a marketplace with a low incidence of tax avoidance.

### **Reaching the End Game**

The recent draft regulations indicate the U.S. Treasury has taken the consultative process seriously and taken steps to ease the tax reporting burden on foreign financial institutions by providing appropriate carve outs for accounts with minimal incidence of tax avoidance, and conforming to the reporting standards to global practice. While reliance on an intergovernmental approach to tax reporting is a positive step, the details of the agreements are critical to assess the net benefit. The consultation process on the regulations will continue apace. While much work remains -- and recognizing "the devil is in the details" -- the willingness of the U.S. Treasury to work towards practical principles gives us confidence we will reach an acceptable compromise on the FATCA regulations. The priority will be confirming the specific carve-outs from due diligence requirements, reaching an acceptable compromise on the treatment of OTC swap and repo/lending transactions, and assisting the Department of Finance and Canada Revenue Agency reach an efficient tax information sharing arrangement with the U.S. Treasury to minimize the compliance burden on individual firms.

The FATCA legislation will remain a burden on firms, but we are determined to pare that back as far as possible. We can understand that U.S. agencies want to assure tax compliance -- but we are determined to ensure that Canadian firms do not find themselves tangled in a bureaucratic net for no reason.

Yours, sincerely,



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