U.S. Developments and Implications for Canadian Tax Planning

Kimberly S. Blanchard, Esq.

Weil, Gotshal & Manges LLP, New York

FATCA - Overview

- The Foreign Account Tax Compliance Act ("FATCA") was enacted to combat tax evasion by US taxpayers by forcing disclosure and reporting of US accounts held outside of the United States.
  - It is not intended to function as a revenue raiser.
  - The withholding tax is a big stick to force reporting.
- FATCA generally requires 30% withholding on specified US source payments made to certain non-US entities that are not exempt or deemed compliant with FATCA.

FATCA – Covered Payments

- Payments subject to FATCA withholding include payments of interest (including original issue discount), dividends, rents, royalties and other types of income from US sources, as well as payments of gross proceeds from disposing of stocks, securities and debt instruments that produce or could produce US source interest or dividends.
  - Thus, if a debt instrument gives rise to US source income and is subject to FATCA, principal repayments will be subject to 30% withholding.

FATCA – Classes of Payees

- FATCA applies to two broad classes of non-US persons:
  - Foreign financial institutions ("FFIs") that have not entered into an agreement with the IRS, unless such FFI is exempt from, or deemed-compliant with, FATCA.
    - Includes banks, investment funds and other investment entities
    - Is impacting cross-border loan markets
    - Is impacting private equity and other investments funds
  - Non-financial foreign entities ("NFFEs") unless the beneficial owner of the payment provides the withholding agent certification that such owner does not have any "substantial US owners" or provides the information for each substantial US owner.
    - Includes most other non-US entities, with various exceptions including exceptions for publicly traded and for active companies

FATCA – Additional Rules

- Grandfathered Obligations. Generally, but subject to certain exceptions, any withholdable payment made under any US debt obligation outstanding on January 1, 2013, and any gross proceeds from the disposition of such obligation, will not be subject to FATCA withholding.
- Phase in of withholding. Withholding is scheduled to begin on January 1, 2014, on payments other than gross proceeds. Withholding on gross proceeds will not begin until January 1, 2015.
- Uncertainty still exists. Although proposed Treasury Regulations issued in February 2012 added needed clarity to FATCA, the regulations are incomplete, have not yet been finalized and are subject to change.

Reporting Requirements - FBAR

- Every US person who has a financial interest in, or signature or other authority over, a bank, securities, or other financial account within a foreign country must file a foreign bank account report (“FBAR”) on Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts, if the aggregate value of such accounts during the year exceeds $10,000.
- The term “other financial account” includes an equity investment in a “mutual fund or similar pooled fund” that issues shares available to the general public and which makes regular net asset value determinations and regular redemptions.
- This reporting requirement applies to all US citizens, regardless of where resident.

Reporting – Foreign Financial Assets

- IRC 6038D requires individuals who own hold an interest in a specified foreign financial asset (including any interest in a foreign entity) and hold, in the aggregate, $50,000 in specified foreign financial assets, to attach to their returns certain information pertaining to such specified foreign financial assets.
- Notice 2011-55 temporarily suspended information reporting under this section for taxable years beginning on or after March 18, 2010, as to returns required to be filed prior to the release of new forms implementing these requirements. Upon the release of the forms, shareholders will be required to attach the forms for any suspended years to their next income tax or information return required to be filed.
  - Form 8938, covering §6038D, has been released.
  - A related revised Form 8621, covering so-called “PFICs,” has not yet been released.
- This reporting requirement, like all US reporting requirements, applies to all US citizens, regardless of residence.

Reactions in Canada

- FATCA represents an unfair extraterritorial application of US law and a waste of resources on both sides of the US-Canada border, Canadian Finance Minister Jim Flaherty said Sept. 16, 2011.
- Flaherty's letter also criticized the US FBAR filing requirements, which he said are negatively affecting large numbers of dual US-Canadian citizens and their relatives that live in Canada. He stated that many Canadian citizens affected have only distant links to the United States and have very limited knowledge of their US tax reporting obligations.
- “Because they work and pay taxes in Canada, they generally do not owe any taxes in the United States in any event. Their only transgression is failing to file the IRS paperwork they were never aware they were required to file.”
- “The threat of prohibitive fines for simply failing to file a return they were unaware they had to file is a frightening prospect that is causing unnecessary stress and fear among law-abiding, hard-working dual citizens,” Flaherty said.
- Why is Canada NOT one of the nations party to the FATCA compliance initiative?

Withholding on Dividend Equivalents

- Section 871(m), enacted in 2010 along with FATCA, requires US withholding on dividend equivalent payments.
  - Originally scheduled to become effective earlier this year, the effective date has been postponed until 2013.
- In general, the purpose of this new rule is to prevent the avoidance of US withholding tax on dividends by non-US persons, often by entering into a total return swap with a US broker.
  - But the rules as proposed sweep much more widely.
- Relevant to exchangeable shares deals?

Covered Asset Acquisitions

- Section 901(m), also enacted in 2010, denies the benefit of a basis step-up, for US foreign tax credit purposes, in the case of any "covered asset acquisition," including a § 338 qualified stock purchase.
- The effect will be generally to make acquisitions of Canadian targets by US acquirors less attractive.
  - However, if a basis bump can be obtained for Canadian tax purposes, the application of the rules will be ameliorated.
  - It follows that there will be additional reasons to secure the bump where feasible.