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FATCA for investment funds – Be ready for May 1, 2015!

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The *Foreign Account Tax Compliance Act*, or FATCA, has been an integral part of Canada's tax system for over a year. Originally legislated under U.S. law, FATCA allowed the Internal Revenue Service ("IRS") to obtain information from financial institutions about the financial accounts of U.S. citizens and residents. This U.S. regime was introduced into Canada through the Intergovernmental Agreement for the Enhanced Exchange of Tax Information under the Canada-U.S. Tax Convention ("IGA") and then through the enactment of Part XVIII of the *Income Tax Act*. Under Canada's FATCA regime, Canadian financial institutions, including several investment funds, are required to file their first report on their U.S. reportable accounts by May 1, 2015.

STATUS

Under the FATCA, only Canadian financial institutions can have obligations to register and report the U.S. reportable accounts they maintain. Investment funds are generally considered a Canadian financial institution. An investment fund, its general partner, fund manager and holding companies are usually required to report under the FATCA rules. A fund's limited partners may also have their own FATCA obligations. Most Canadian investment funds have addressed the issue of their FATCA status and obtained a global intermediary identification number (or "GIIN") from the IRS.

However, there is still some uncertainty which can cause market players to put off analyzing their obligations or registering. There are several reasons for this, including the fact that the rules are relatively new, the lack of formal administrative positions regarding their application, qualification and exception issues, etc. For an investment fund, these issues require an in-depth analysis of all entities forming part of its structure in order to come to an adequate determination.

It should be noted that an investment fund that determines that it does not qualify as a financial institution for the purpose of FATCA could be considered a passive non-financial foreign entity and be required to report such information at the request of a financial institution and disclose more information about its beneficiaries in order to determine their status.

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DUE DILIGENCE

A reporting Canadian financial institution is required to determine whether the financial accounts it maintains for its clients contain U.S. indicia (residence and citizenship of account holder, place of birth, mailing address, telephone number, etc.). This verification includes a review of available information about the account by the financial institution and a mechanism for requesting information. Such a request may be in the form of an IRS Form W-8, an official IRS document, or an equivalent document prepared by the financial institution, to be filled out by the account holder.

A financial institution is required to collect this information for existing accounts and any new account it opens for a client. The financial institution's verification obligations may be more or less strict depending on the account, the date it was opened and its value.

REPORTING

Canadian financial institutions are required to file an electronic report on their U.S. reportable accounts with the Canada Revenue Agency ("CRA"). The first such report covers financial accounts held by financial institutions as of December 31, 2014 and must be filed by May 1, 2015.

Financial institutions must also complete, by June 30, 2015, a review of their high-value financial accounts, i.e. those worth one million dollars ($1M) or more, held as of June 30, 2014.

After that, financial institutions will be required to file annual reports.

EVOLUTION

The FATCA rules are the precursor of a broad, evolving trend toward the exchange of information about taxpayers' assets among the tax authorities of different countries. The United Kingdom has set up a similar although less wide-sweeping regime than the U.S. China is also looking at the possibility of setting up its own regime but has not released any details so far. The Organisation for Economic Co-operation and Development ("OECD") has also set up a common standard for the automatic exchange of information regarding financial accounts, which Canada has committed to implement by 2018. This standard is expected to be similar to FATCA but involve all countries that have signed agreements involving the automatic exchange of information.

In future we will certainly see greater transparency and increased reporting requirements regarding information about financial accounts to be provided to the tax authorities.

Since investment funds are directly affected by these rules, they should make sure they have the tools they need to meet these requirements.

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