August 05, 2020

ARTICLE

FATCA and CRS compliance for client name accounts

Canadian financial institutions (FFIs) are subject to Canada's implementation of the Foreign Account Tax Compliance Act (FATCA) and the Common Reporting Standard (CRS) compliance regimes. On July 10, 2020, the Canada Revenue Agency (CRA) released new versions of the FATCA Guidance and CRS Guidance (collectively, the Guidance).

The changes in the Guidance will significantly affect fund managers and dealers in the context of client name accounts (*i.e.,* investment fund units sold through dealers issued in the name of the beneficial owner). The relevant changes relate to reportable accounts with missing foreign taxpayer identification numbers (TINs), and how the CRA imposes the resulting penalties against fund managers and dealers.

This bulletin addresses the unique challenges of non-compliance penalties in the context of client name accounts. It also provides possible solutions for both fund managers and dealers.

What You Need to Know

- For client name accounts, the default allocation of responsibilities for FATCA and CRS compliance is as follows: (i) dealers are responsible for conducting due diligence and account classification; and (ii) fund managers are responsible for filing the information return.
- Effective 2021, the CRA will begin assessing penalties for non-compliance. This includes a penalty of up to $5,000 per account for not obtaining a valid self-certification when required and a penalty of $100 for each failure to provide a TIN on an information return.
- If there are missing TINs on an information return, the CRA will contact the filer of the return to resolve the issue and potentially assess the non-compliance penalties against the filer as well. This means the fund manager is potentially liable for non-compliance penalties that result from the dealer's failure to collect the TINs.

Fund manager and dealer responsibilities

In the context of client name accounts, fund managers and dealers have different responsibilities for FATCA and CRS compliance.

The CRA indicates the default allocation of responsibilities is as follows:

- Dealers are responsible for conducting due diligence (*i.e.*, obtaining a valid self-certification from the account holder with the account holder's TIN) and classifying the appropriate accounts as reportable; and
- Fund managers are responsible for filing the information return by May 1.[1]

However, an agreement between the dealer and the fund manager can override the default allocation of responsibilities. For example, the dealer may choose to perform both the due diligence and information reporting obligations in respect of the accounts.

Penalties for non-compliance

FFIs may be liable for non-compliance penalties under both FATCA and CRS. The penalties include:

- Up to $5,000 per account for not obtaining a valid self-certification when required (*i.e.,* a penalty of up to $2,500 for FATCA and a penalty of up to $2,500 for CRS) pursuant to subsection 162(7) of the *Income Tax Act* (ITA); and
- $100 for each failure to provide a TIN on an information return pursuant to subsection 162(5) of the ITA (unless the FFI makes reasonable efforts to obtain the information from the account holder).

The penalties for non-compliance have always existed in the ITA, but the CRA has chosen not to apply them. However, the Guidance states that the CRA will begin assessing these penalties in 2021. As a result, FFIs may soon face large penalties if they are non-compliant across multiple accounts.

There are also additional penalties for significant non-compliance under FATCA. Examples of significant non-compliance include repeated failures to file the Part XVIII Information Return and omitting required information (such as TINs) from the return. In these cases, the FFI will be treated as a nonparticipating financial institution – this means the Internal Revenue Service (IRS) may revoke the FFI's global intermediary identification number (GIIN), which would be detrimental to the fund's or dealer's ability to hold or offer investments in U.S. securities.

The unique problem with client name accounts

After the FFI files its annual information return, the CRA shares the information with foreign tax authorities. Upon receiving any account information with missing TINs, the foreign tax authority will likely request the missing TINs from the CRA. The CRA will then forward this request to the FFI that filed the information return, at which point the FFI is obligated to contact the account holders to resolve the missing TINs.

The issue with non-compliance for client name accounts relates to the division of responsibilities between fund managers and dealers. The CRA connects the account with the missing TIN to the FFI that completed the information reporting. Based on the division of responsibilities, the CRA will contact the fund manager for the missing TIN and will potentially assess the fund manager for any non-compliance penalties.

This is problematic, because dealers are responsible for conducting due diligence and obtaining the TINs. Theoretically, the dealer should be held accountable for resolving the missing TINs. The dealer should also be liable for the non-compliance penalties since it is responsible for collecting the TINs in the first place. However, this may not be possible. The CRA has no mechanism to connect the account with the missing TIN to the dealer that conducted the due diligence, since the information return does not ask the filer to identify the person that conducted the due diligence.

As a result, fund managers will likely be responsible for resolving any missing TINs. Fund managers could also be liable for non-compliance penalties relating to the dealer's due diligence obligations. At the same time, if the IRS believes that there is significant non-compliance due to a large number of missing U.S. TINs, and the FFI is unable to resolve the non-compliance issues within the appropriate time frame, the fund's FFI status will be revoked and its GIIN removed from the IRS list. Not only will a revocation of FFI status result in the fund becoming subject to the 30 per cent U.S. withholding tax on payments of certain U.S. source income (*e.g.*, dividends, interest, etc.), but it may also prove problematic for its future dealings with other FFIs.

Possible solutions for your organization

Based on how the CRA is expected to handle missing TINs and the resulting penalties, fund managers may be liable because of the dealer's failure to collect the TINs. It is imperative that fund managers and dealers have solutions to this problem, as fund managers should not be liable for deficiencies in the dealer's due diligence obligations.

BLG is committed to helping both fund managers and dealers resolve this issue. For assistance in managing your organization's risks relating to client name accounts, please contact any of the members of BLG's Investment Management group listed below.

---

[1] For information returns relating to the 2019 taxation year, the filing deadline has been extended to September 1, 2020 as a result of COVID-19. Please see our previous bulletin for more information.

By: Grace Pereira, Tony Zhang

Services: Banking & Financial Services, Investment Management, Tax

---

Key Contacts

Grace Pereira
Partner

Toronto

GPereira@blg.com

416.367.6092

Sarah Gardiner
Partner

Toronto

SGardiner@blg.com

416.367.6221

Ronald (Ron) M. Kosonic
Partner

Toronto

RKosonic@blg.com

416.367.6621

Jason Brooks
Partner

Vancouver

JBrooks@blg.com

604.640.4102

Robert D. Wallis
Partner

Calgary

RWallis@blg.com

403.232.9203

Related Content

Newest developments on FATCA and CRS compliance

Latest developments on FATCA and CRS compliance

Canadian FATCA Compliance Update