When is a Financial Institution not a Financial Institution: CRA Announces New Administrative Positions on FATCA/CRS Compliance

April 05, 2024

Today, the Canada Revenue Agency (CRA) published its new administrative positions on the compliance obligations of financial institutions under Part XVIII (FATCA) and Part XIX (CRS) of the *Income Tax Act* (Canada).

These new administrative positions can be found in the Guidance on the Canada-U.S. Enhanced Tax Information Exchange Agreement (the Updated FATCA Guidance) and the Guidance on the Common Reporting Standard (the Updated CRS Guidance), both of which were released in revised form on April 5, 2024.

What you need to know

- Canadian financial institutions that are subject to FATCA/CRS (FIs) include depository institutions, custodial institutions, investment funds and certain insurance companies. FIs will need to revise their FATCA/CRS compliance procedures to address CRA's new administrative positions.
- Of note, the Updated FATCA Guidance and the Updated CRA Guidance provide as follows:
    - For both FATCA and CRS compliance, the FI's verification of an account holder's global intermediary identification number (GIIN) is considered insufficient, in and of itself, for determining the account holder's status as a financial institution.
    - For FATCA compliance, the treatment of a first home savings account (FHSA) as an exempt account is now official.

FATCA/CRS: Confirming an account holder's status as a financial institution

Where an FI maintains an account for an account holder that is another financial institution (FI Client), the FI Client is generally not considered a reportable person for FATCA/CRS (by reason of the FI Client being a financial institution). Accordingly, as

part of the FI's due diligence process, it will need to confirm that the FI Client is, in fact, a financial institution.

Prior to the release of the Updated FATCA Guidance and the Updated CRS Guidance (collectively referred to as the "Updated Guidance"), the FI was able to discharge its due diligence obligation in respect of the FI Client by verifying that the FI Client has been issued a GIIN through the Internal Revenue Service's Foreign Financial Institution (FFI) List.

As a result of the Updated Guidance, the CRA now takes the position that it is no longer sufficient for an FI to verify FI Client's status as a financial institution solely through confirming the FI Client's GIIN. The CRA's new position now indicates that FIs should take additional steps to reasonably determine the account holder's status as a financial institution (*i.e.,* steps in addition to verifying the GIIN), such as obtaining:

- An attestation from the relevant jurisdiction confirming that the FI Client is a financial institution in that jurisdiction; or
- An attestation from the licensing authority for the FI Client confirming that the FI Client's license is valid.

FATCA: FHSAs are officially exempt accounts

Prior to the release of the Updated Guidance, the CRA's administrative position was that FIs did not need to conduct due diligence or reporting in respect of FHSAs even though FHSAs were not legislatively excluded from FATCA/CRS (the Interim FHSA Position). The Interim FHSA Position recognized that while the relevant Canadian laws had not yet been changed to exempt FHSAs from FATCA/CRS compliance, such laws would be changed in due course.

In the context of FATCA, the CRA and Internal Revenue Service signed a competent authority arrangement (CAA) on February 1, 2024 to updated Annex II of the *Canada – U.S. Intergovernmental Agreement to Improve International Tax Compliance through Enhanced Exchange of Information* (IGA). As a result of the CAA, FHSAs are now legislatively considered excluded accounts for purposes of an FI's FATCA compliance. The Updated FATCA Guidance explains the recent development with the CAA.

As of the date of this bulletin, the *Income Tax Act* (Canada) has still not been amended so that FHSAs are also legislatively exempt from CRS. However, in accordance with the Interim FHSA Position (which is still provided for in the Updated CRS Guidance), FIs are able to continue treating FHSAs as exempt accounts for purposes of CRS.

How these changes impact FIs

FIs will need to significantly change their due diligence procedures when dealing with account holders that are FI Clients. For FIs that are currently only verifying the FI Client's GIIN as part of the due diligence process, it will now be important for such FIs to incorporate additional steps to verify that the FI Client is truly a financial institution.

This change will be particularly impactful for investment funds whose units are issued in nominee-name (as opposed to client-name). For these funds, prior to the release of the

Updated Guidance, the fund's due diligence obligation only required the fund to confirm that the dealer has been issued a GIIN. As a result of the Updated Guidance, managers of such Funds will now need to take additional steps in order to confirm that the dealer is truly a financial institution.

In light of the changes in CRA's administrative position described in this article, we recommend FIs take the following steps:

- Determine how they will incorporate the CRA's new administrative position for account holders that are FI Clients. In particular, what additional steps will FIs take to reasonably determine the FI Client's status as a "financial institution"? For example, will the FI's additional steps be obtaining the attestations suggested by the CRA, or will it be another set of reasonable steps developed by the FI?
- Update account agreements to reflect the new documents that FI Clients may need to provide to the FI (such as an attestation).
- For investment funds, fund manufacturers should update their subscription agreements to reflect the changes in the CRA's new administrative positions.
- Provide training to the FI's employees and independent contractors that are involved in the due diligence process (especially training pertaining to the FI's newly implemented additional due diligence steps in regards to FI Clients). Copies of all materials and attendance records for these trainings should be retained by the FI in the event of an audit by the CRA.

If you have questions on how these changes may impact your FI, or if you would like assistance with implementing the above recommendations for your FI, please contact Tony Zhang or Grace Pereira.

By

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