Forensic Accounting & Fraud Magazine
▶View the Digital Edition

THE BOTTOM LINE
The Independent Voice for Canada's Accounting and Financial Professionals

www.lexisnexis.ca Vol. 31, No. 13 October 2015

Way paved for CRA to share info with IRS

By Donalee Moulton

October 2015 issue

An 11th-hour legal salvo to halt the flow of personal and account holder information demanded under the United States Foreign Account Tax Compliance Act (FATCA) has failed, leaving no barrier to Canadian banks submitting the data about their U.S. customers to the Canada Revenue Agency for dissemination to the U.S. Internal Revenue Service.

The Federal Court of Canada quashed the request for a permanent injunction brought forward by two women with dual U.S. and Canadian citizenship who both reside in Canada. The plaintiffs advanced numerous arguments to demonstrate why the intergovernmental agreement between the two countries that would allow for private accountholder information to be shared with the IRS is illegal.

"The court made it very clear it wasn't buying any of these arguments," said Roy Berg, director of U.S. tax law at Moodys Gartner Tax Law in Toronto.

The plaintiffs, who have not resided in the U.S. since they were children, argued they have "no real connection" to the United States and that their citizenship is "an accident of birth" that has little significance. They further contended that as bona fide residents of Canada they have no fiscal obligations to the U.S. and that there should be no taxation without representation. The court disagreed.

"The plaintiffs may see themselves as 'accidental Americans' but the application of fiscal law is not concerned with rhetoric: it focuses on the actual reality of each taxpayer and his or her taxable income," said Justice Luc Martineau in his Sept. 16 decision Hillis et al v. Attorney General of Canada and the Minister of National Revenue [2015] FC 1082.

"It is not true that under U.S. domestic law U.S. citizens who are bona fide residents of Canada bear no fiscal obligations to the U.S. Being a citizen of any state normally carries benefits … There are also obligations."

The lawyers for Virginia Hillis, a retired lawyer from Windsor, and Gwendolyn Deegan, a graphic designer from Toronto, also argued that under the Canada-U.S. Tax Treaty, Canada cannot assist the United States in collecting revenue, and that the Canadian government cannot subject any U.S. national to "any taxation or requirement" that is more burdensome than "the taxation and connected requirements" to which Canadian nationals are subjected.

"All these arguments are unfounded in law or otherwise unconvincing in light of the evidence on record," Justice Martineau stated. He determined that the plaintiffs had misread the intergovernmental agreement, the Canada-United States Enhanced Tax Information Exchange Agreement Implementation Act, and that the authority to exchange information automatically on an annual basis is not expressly prohibited under the tax treaty.

Ultimately, though, the court's reluctance to grant a permanent injunction was tied to the fact that it believed such judicial intervention was not necessary. The plaintiffs, the court said, had the means to deal with this issue at their disposal. The judge questioned openly whether it would have the authority to address the issue even if there was a treaty violation, noted Berg.

"These people are U.S. citizens. They have the ability to handle this on their own by renouncing their citizenship," he said.

Sunita Doobay, a U.S. and Canadian cross-border tax partner with TaxChambers LLP in Toronto, pointed out that had the plaintiffs been successful in their case before the Federal Court, they would still have to file financial information with the U.S. government under that country's Report of Foreign Bank and Financial Accounts (FBAR) legislation. "Even if the Canadian banks did not gather this information for remittance to the U.S., the obligation would still be on the U.S. citizen in Canada to fill out the FBAR form and all other information returns. So I am not sure where this lawsuit was heading."

The court's decision is clearly a relief for Canadian banks. If the plaintiffs had been victorious, financial institutions would not have been able to share account information with the CRA for dissemination to the IRS, as required under the intergovernmental agreement signed between the two countries in 2014. However, not sharing that information under FATCA, enacted by the U.S. government in 2010, would have resulted in Canadian banks being hit with a 30 per cent withholding tax.

The U.S. government's quest for financial information is a sign of the times, said Doobay.

"We are moving into a society where information is gold, not only to companies but to governments solely in need of revenue."
The search has resulted in the Canadian government signing treaties and tax information agreements with countries, including those once considered tax havens such as Lichtenstein.

"The old days of parking a few million in Lichtenstein" are "no longer possible," said Doobay.

U.S. citizens in particular should not be surprised by the government's requirement for financial information, she added. The United States is one of only two countries in the world that requires citizens to file an annual income tax form no matter where they live. (The other country is Eritrea).

"I am often astonished at the outcry [over] compliance," said Doobay. "It is part of the requirement in holding U.S. citizenship. It is the price one must pay."

The situation continues to unfold. The recent decision was appealed; however, the Canadian Federal Court of Appeal had not ruled on a motion to prevent the transfer of information between Canada and the U.S. by the Sept. 30 deadline imposed under the intergovernmental agreement. This silence serves as a green light for the CRA to release information pertaining to roughly 155,000 accounts.

Another last-minute hope has also evaporated. This summer, the Internal Revenue Service issued Notice 2015-66, which under certain circumstances allows countries with an intergovernmental agreement to delay sending financial information by a full year, to Sept. 30, 2016, provided it gives the U.S. a heads-up it will not be filing until then.

This option is not open to Canada, *The Bottom Line* has learned. In an affidavit signed by the Canada Revenue Agency's director of competent authority, the IRS has informed the CRA that the "U.S. was not prepared to grant Canada an extension because the Canadian situation is not covered by the notice criteria, as the legislation and systems are in place to be able to effect the exchange." Further, the affidavit states, "this was the U.S. position even if Canada is subject to a court ordered injunction."

Still, the fight for exemption under FATCA is not yet over. A Charter-based case is moving forward in Canada and arguments on the constitutionality of sharing account information of U.S. citizens will be heard next year.
In the meantime, prudence is warranted.

"Accountants and lawyers need to identify U.S. citizens and [they] need to be aware their information will be handed over to the IRS," said Berg. "You need to be savvy to how the IRS treats tax. These are issues that have been ignored for years.

"With FATCA, no professional is in the position of being able to offer advice without considering the U.S. implications."