The Canadian regime raises a host of questions that arise primarily from the diverging scope of terms in the different bodies of rules applicable to Canadian investment entities, including the Canada IGA, Canadian implementing legislation, and FATCA Regulations.

MATIAS MILET

FATCA
CANADIAN INVESTMENT ENTITIES

"Investment entities," as defined broadly in the FATCA Regulations,[1] that are resident in Canada now have detailed guidance for determining their status under FATCA. Canada and the United States entered into a Model 1 intergovernmental agreement (IGA) on February 5, 2014, that came into force on June 27, 2014 (Canada IGA).[2] Canada enacted legislation to implement the Canada IGA on June 19, 2014. On December 23, 2014, the Canada Revenue Agency (CRA) released 160 pages of guidance notes on the Canada IGA and the Canadian legislation (CRA Guidance).[2.1] Each of these sources contains detailed provisions for determining the FATCA status (e.g., reporting Model 1 foreign financial institution (FFI), non-reporting IGA FFI, or non-financial foreign entity (NFFE))[3] of the types of Canadian resident entities that would be considered investment entities under the FATCA Regulations. While providing many answers, however, the Canadian regime also raises a host of questions that arise primarily from the diverging scope of terms in the different bodies of rules applicable to Canadian investment entities, including the Canada IGA, the Canadian implementing legislation, and the FATCA Regulations.[4]

Canada-U.S. IGA[5]

The Hiring Incentives to Restore Employment (HIRE) Act of 2010 (P.L. 111-147, March 18, 2010) added Chapter 4 to the Code (Sections 1471-1474) (FATCA) with a view to curbing offshore tax evasion by U.S. citizens and residents holding assets through non-U.S. financial intermediaries. Absent an IGA, FATCA would have required Canadian resident investment entities and other FFIs to enter into an agreement (FFI Agreement) with the

IRS to identify U.S. accounts and report information on those accounts to the IRS (such an FFI is a "Participating FFI"). FATCA also requires NFFEs, other than excepted NFFEs, to provide information regarding their substantial U.S. owners to U.S. withholding agents. Failure by an FFI to enter into an FFI Agreement or by an NFFE to provide the required information generally would have resulted in the imposition of a 30% withholding tax on "withholdable payments"[6] made to these noncompliant payees.

FATCA raised several concerns in Canada including whether Canadian FFIs could be compelled to report information directly to the IRS while complying with Canadian privacy laws. The Canada IGA attempts to address those concerns by requiring Canadian FFIs to provide information on U.S. accounts to the CRA, which will make the information available to U.S. tax authorities under the exchange-of-information Article (Article 27) of the 1980 Canada-U.S. income tax treaty. In addition, under the Canada IGA, the United States commits to provide the CRA with certain information about accounts that Canadian residents hold in U.S. financial institutions.

The Canada IGA and the related annexes conform closely to the Reciprocal Model 1 IGA that has served as the basis for the IGAs that the United States has signed with at least 35 other countries.[7] Like these other IGAs, the Canada IGA is intended to streamline FATCA information reporting, reduce FATCA compliance burdens for financial institutions, and allow for FATCA compliance in a manner that is consistent with applicable privacy and other laws in the IGA country.[8] However, notwithstanding the reduced compliance burdens, a constitutional challenge has been launched in a Canadian court against the application of U.S. FATCA rules in Canada.[9]

A reporting Canadian financial institution that complies with the requisite due diligence and reporting requirements and registers with the IRS in accordance with the Canada IGA is generally eligible to be treated as a reporting Model 1 FFI and as a registered deemed-compliant FFI under the FATCA Regulations.[10] As a consequence, such a reporting Canadian financial institution will not have to enter into an agreement directly with the IRS to be exempt from withholding tax under FATCA. The Canada IGA also relieves Canadian FFIs of certain obligations that otherwise would be imposed under FATCA, including the obligation to withhold on payments to, or to close accounts of, recalcitrant accountholders (including accountholders who do not provide requested information to establish their identity), if the IRS receives specified information with respect to the accounts.

Like the Reciprocal Model 1 IGA, the Canada IGA includes an annex (Annex II) that exempts specified entities and financial products with a low potential for U.S. tax avoidance from FATCA's reporting and withholding regime. Very generally, Annex II establishes that, among other entities, the Bank of Canada, certain international organizations operating in Canada, and certain pension and retirement funds will be treated as "exempt beneficial owners" for FATCA purposes and, therefore, will not be subject to FATCA withholding.[11] FATCA withholding will also not apply to certain entities that Annex II treats as "deemed-compliant FFIs," including Canadian financial institutions that provide financial services only within Canada to Canadian residents, certain Canadian non-profit organizations, and certain entities formed by non-profits and pension plans. These entities also will not be required to comply with the due diligence and reporting requirements under FATCA. Although a discussion regarding the Chapter 4 status of tax-exempt Canadian financial institutions (or their pooling vehicles) that may qualify as investment entities is beyond the scope of this article, it is relevant for present purposes that Annex II generally treats investment entities in which the investors

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are exclusively certain Canadian resident tax-exempt investors—such as pension plans, charities, or foundations—as non-reporting Canadian financial institutions and as deemed-compliant FFIs for purposes of Section 1471.[12]

The Annex also excludes from the definition of "financial account" certain accounts and products, including registered retirement savings plans, registered retirement income funds, pooled registered pension plans, registered pension plans, tax-free savings accounts, registered disability savings plans, registered education savings plans, and deferred profit-sharing plans. The effect of this exclusion is that reporting Canadian financial institutions will not be required to obtain information from, or report information about, these accounts.

The Canada IGA requires reporting by Reporting Canadian Financial Institutions[13] with respect to accounts held by Passive NFFEs that have as controlling persons one or more U.S. residents or citizens.[14] Thus, a Canadian resident Passive NFFE that wants to comply with the Canadian FATCA regime will be called on to collect and provide information regarding itself and certain of its U.S. accountholders. Accordingly, having Passive NFFE status may entail considerable information collecting and reporting obligations.

FATCA Comes to Canada: ITA Part XVIII

The Canada IGA is a bilateral instrument that is binding on the two contracting states, and by itself does not impose obligations directly on Canadian FFIs (although it spells out which obligations Canada agrees to impose on these FFIs). To put in place the legal framework that would impose domestic law obligations on reporting Canadian financial institutions to collect and report information to the CRA (largely as the Canada IGA indicates), Canada enacted an entirely new Part of the Income Tax Act (Canada) (ITA). New ITA Part XVIII includes provisions that require reporting Canadian financial institutions to establish and maintain due diligence procedures, file an annual information report with

the CRA, and maintain certain documentary records. The information that the CRA collects will be provided automatically to the IRS pursuant to the exchange-of-information provisions in the Canada-U.S. tax treaty. While Part XVIII incorporates by reference many of the definitions, procedures, and rules in the Canada IGA, it also significantly modifies the scope of some concepts in the IGA.

Interaction of the IGA and ITA

Under the Canada IGA, a Canadian entity (including a partnership) will be a Reporting Canadian Financial Institution, Non-Reporting Canadian Financial Institution, or an NFFE.[15] Generally, the Canada IGA and ITA Part XVIII impose comprehensive due diligence and reporting obligations on Reporting Canadian Financial Institutions and not on Non-Reporting Canadian Financial Institutions.

A Non-Reporting Canadian Financial Institution is any Canadian Financial Institution, or other Entity resident in Canada, that is identified in Annex II as a Non-Reporting Canadian Financial Institution or that otherwise qualifies as a deemed-compliant FFI or an exempt beneficial owner under the FATCA Regulations in effect on February 5, 2014 (the date that Canada and the United States signed the IGA). Because of the residual language ("any other Entity resident in Canada"), despite the words "Financial Institution" in "Non-Reporting Canadian Financial Institution," the phrase can apply to a Canadian resident entity that is not a Financial Institution (and that is either listed in Annex II or qualifies as a deemed-compliant FFI or exempt beneficial owner under the FATCA Regulations). This is helpful to certain investment entities that otherwise would be listed in Annex II but either do not clearly satisfy or would prefer not to affirm that they satisfy all of the conditions to be an Investment Entity (and thus a Financial Institution) as defined by the Canada IGA.[16]

The scope of what constitutes a "Reporting Canadian Financial Institution" under the Canada IGA is considerably broader than that of the corresponding term in ITA Part XVIII. As a result, while Canada may have obligated itself vis-a-vis the United States to create certain reporting obligations in respect of a broad range of entities, it in fact imposed those obligations under domestic law on a narrower range. Under the Canada IGA, a Reporting Canadian Financial Institution is defined as any Canadian Financial Institution that is not a Non-Reporting Canadian Financial Institution. Canadian Financial Institutions generally are Custodial Institutions, Depository Institutions, Investment Entities, and Specified Insurance Companies that are resident in Canada (or the Canadian branch of such a nonresident entity).

The Canada IGA does not define "resident." The CRA Guidance provides that residence for most entities will be determined under the usual Canadian statutory and factual tests. Although a partnership, as a type of Entity, can be a Financial Institution, there is no general concept of partnerships being residents (or nonresidents) of Canada under Canadian income tax law. However, the CRA Guidance states—in an effort to be helpful and provide a test where none may have existed—that if the control and management of a partnership's business takes place in Canada, the partnership is resident in Canada under the Canada IGA.

1 Treasury and IRS released two sets of final and Temporary Regulations (TD 9657, TD 9658, February 20, 2014) under FATCA. TD 9657 included changes to Chapter 4 of the Code. TD 9658 coordinated the documentation standards and reporting and withholding rules relating to payments to non-U.S. and U.S. persons (Chapters 3 and 61 and Section 3406 of the Code), with the FATCA Regulations. See PwC, "More FATCA Regulations," 25 JOIT 23 (May 2014).

2 See "FATCA IGA Update—Nine More Countries," 25 JOIT 6 (March 2014); "U.S.-Canada Sign Long-Awaited FATCA IGA," 25 JOIT 5 (April 2014).

2.1 The CRA Guidance was initially released on June 23, 2014, and later amended to reflect stakeholder comments.

3 These categories reflect the nomenclature in the FATCA Regulations and on Form W-8BEN-E (Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities)). The Canada IGA and the Canadian implementing legislation use other terms that have overlapping scope. For example, a reporting Canadian financial institution as defined in the Canadian legislation is a Reporting Model 1 FFI as defined in the FATCA Regulations.

4 This article focuses in particular on the Chapter 4 status of Canadian investment entities and does not address the Chapter 4 status of other types of Canadian financial institutions or the FATCA due diligence, reporting, and withholding requirements applicable to Canadian financial institutions, including investment entities. For a comprehensive (and excellent) overview, see Chong, "Canada and FATCA," 43 Tax Mgmt. Int'l J. (Bloomberg BNA) 527 (September 12, 2014).

5 The description of the Canada IGA that follows (not including the further discussion of how the IGA interacts with the ITA) is based on a publication by colleagues of the author. See Colan, Corcoran, Marley, and Seraganian, "Canada Signs FATCA Intergovernmental Agreement With the United States" (February 6, 2014), www.osler.com/NewsResources/Canada-Signs-FATCA-Intergovernmental-Agreement-with-the-United-States.

6 "Withholdable payments" generally include U.S.-source interest, dividends, rents, salaries, wages, premiums, annuities, and compensation, as well as gross proceeds from the sale or disposition of property that can produce U.S.-source interest or dividends. Section 1473(1)(A)(i). (Unless otherwise stated, "Section" refers to the U.S. Internal Revenue Code.)

The ITA generally defines a "reporting Canadian financial institution" as a Reporting Canadian Financial Institution within the meaning of the Canada IGA that is also a "listed financial institution," as defined in new ITA section 263. Thus, there are two components to the ITA definition. First, applying the Canada IGA definitions, the relevant entity must be a Financial Institution—and, as such, a Custodial Institution, a Depository Institution, an Investment Entity, or a Specified Insurance Company—that is not a Non-Reporting Financial Institution. Second, the entity will have to satisfy the ITA definition of "listed financial institution." The "listed financial institution" category, which has no counterpart in the Canada IGA, is a statutory list of financial entities, many of them regulated. There is a specific category for investment entities, which differs from the way that the Canada IGA defines Investment Entities. Article 1(j) of the Canada IGA defines Investment Entity as follows:

> The term "Investment Entity" means any Entity that conducts as a business (or is managed by an entity that conducts as a business) one or more of the following activities or operations for or on behalf of a customer:
>
> (1) trading in money market instruments (checks, bills, certificates of deposit, derivatives, etc.); foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures trading;
>
> (2) individual and collective portfolio management; or
>
> (3) otherwise investing, administering, or managing funds or money on behalf of other persons.

The definition in the Canadian IGA finishes with a statement that "Investment Entity" is to be construed in light of the Financial Action Task Force (FATF) recommendations, a set of guidelines relating to money laundering and terrorist financing that includes a definition of "Financial Institution."[17]

So long as an entity is managed by an asset manager or other institution that conducts any of the activities listed in the above definition as a business, it will be an "Investment Entity." Thus, for example, an environmental remediation trust or a family trust managed by an entity the business of which includes administering or managing funds on behalf of other persons would seem to be an Investment Entity under the Canada IGA. Unlike the definition of "investment entity" in the FATCA Regulations (but as in the Model 1 IGA),[18] there is no requirement in the Canada IGA that the applicable Investment Entity or its manager/administrator "primarily" conduct the listed activities as a business.[19]

The corresponding concept for investment entities in the ITA is not as broad as in the Canada IGA. Paragraph (k) of the ITA definition of "listed financial institutions" (Part XVIII, section 263(1)(k)) refers to an entity that is:

> represented or promoted to the public as a collective investment vehicle, mutual fund, exchange traded fund, private equity fund, hedge fund, venture capital fund, leveraged buyout fund or similar investment vehicle that is established to invest or trade in financial assets and … managed by an entity referred to in paragraph (j).

For such an entity to be a "listed financial institution," it must, among other things, be managed by a "listed financial institution" described in paragraph (j), which refers to an entity that is "authorized under provincial legislation to engage in the business of dealing in securities or any other financial instruments, or to provide portfolio management,

investment advising, fund administration, or fund management, service."

The concept of an investment entity in paragraph (k) of the ITA "listed financial institution" definition, together with its companion description of qualifying entity managers in paragraph (j), includes further limitations that circumscribe which Investment Entities (as defined in the Canada IGA) will be "listed financial institutions" and, therefore, "reporting Canadian financial institutions" under the ITA. Paragraph (k) contains a requirement, which is not in the Canada IGA, that the entity be "represented or promoted to the public" as some sort of investment vehicle. The CRA Guidance says that the requirement will be satisfied even if marketing or other communication efforts are directed at a limited or small group of potential investors. However, the CRA Guidance indicates that trusts that do not seek external capital (such as those used to hold family investable assets) would not satisfy the requirement of being promoted or represented to the public.[20] Thus, for example, the environmental remediation trust and family trust mentioned above as being Canadian Financial Institutions under the Canada IGA would likely not be Canadian financial institutions under the ITA in light of the CRA Guidance and the securities law jurisprudence on the concept of offering investments to "the public."[21]

That the CRA would declare a Hybrid Canadian FI to be an NFFE, while it seemingly remains an FI under Chapter 4, puts the entity in a difficult place in terms of compliance

The further requirement in paragraph (k) that the investment vehicle be "similar" to those types of investment funds listed (e.g., mutual funds, exchange-traded funds (ETFs), and private equity funds) raises questions as to which types of investment entities are sufficiently similar to be "listed financial institutions" under the ITA. The listed categories of investment entities in paragraph (k) provide investors with a return on an equity investment that varies based on the performance of underlying holdings of the vehicle. When an entity issues only debt to investors, who do not participate in the upside of the entity's underlying financial assets, there may be questions as to whether there is the requisite similarity to the listed types of investment vehicles. Depending on the facts, however, the debt-issuing entity may have other features that make it sufficiently similar to the listed investment entities to raise questions as to whether it should be categorized as a paragraph (k) "listed financial institution."

There are several issues regarding the requirement in paragraph (k) that the

7 See "Model 1A IGA Reciprocal, Preexisting TIEA or DTC," www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Reciprocal-Model-1A-Agreement-Preexisting-TIEA-or-DTC-11-4-13.pdf.

8 The Canadian enabling statute that included new FATCA provisions to be added to the ITA provides that in the event of any inconsistency between (1) that statute or the Canada IGA, and (2) any other law, the statute and the IGA prevail to the extent of the inconsistency. See section 4 of "An Act to Implement the Canada-United States Enhanced Tax Information Exchange Agreement," in Part 5 of Bill C-31 (Economic Action Plan 2014 Act, No. 1), enacted June 19, 2014. This provision would appear to permit disclosure or reporting mandated by the Canada IGA or the FATCA provisions of the ITA when this disclosure or reporting to the IRS might otherwise be prohibited under privacy or other laws in Canada—at least to the extent that those laws are federally enacted.

9 Two U.S. citizens resident in Canada have filed a legal action in Canadian federal court seeking a declaration that the Canada IGA, related annexes, and ITA Part XVIII (impugned provisions) are unconstitutional and of no force and effect under Canadian law. The plaintiffs challenge the impugned provisions on two bases: (1) the exclusive jurisdiction that the Canadian constitution grants to provincial governments to pass laws relating to property and civil rights in the provinces and to regulate private industry, including the banking industry, in the provinces, and that the federal government lacks jurisdiction to validly enact the impugned provisions; and (2) that by singling out and disclosing personal information of anyone who meets any of the indicia of a U.S. person or has any connection to a U.S. reportable account under the IGA, the impugned provisions are grossly over-inclusive and unjustifiably violate individual liberty, personal security, and equality rights in Canada's constitution.

10 See Reg. 1.1471-5(f)(1).

11 In addition, smaller deposit-taking institutions, such as credit unions, with assets of less than $175 million are exempt.

12 Specifically, this favorable treatment applies to entities or arrangements described in Article XXI(3) of the Canada-U.S. tax treaty. Section III(l) of Annex II of the Canada-U.S. IGA.

13 See note 15, *infra*, regarding capitalization of terms in this article.

14 "Controlling persons" is defined, in part by reference to the Financial Action Task Force Recommendations, at Article 1(mm) of the Canada IGA.

15 In the remaining discussion, capitalized undefined terms have the meaning given to them in the Canada IGA.

16 For example, an entity that might be classified as an Investment Entity as defined in Article 1(j) of the Canada IGA but is not managed by another entity that conducts as a business the types of activities listed in the definition (such as portfolio management) may have domestic Canadian tax reasons for not wanting to affirmatively take the position that it is an Investment Entity, as it may not want to describe itself as conducting investment activities "as a business," as per the language in Article 1(j). If the entity is resident in Canada and listed in Annex II, it need not affirmatively take the position that it is an Investment Entity. The ITA definition for a non-reporting Canadian financial institution is similar, in that it applies both to any "Canadian financial institution" (which under the ITA requires that the entity be a "listed financial institution," a fairly narrow term as discussed in the text below) or other entity resident in Canada, in each case that meets conditions like those in the IGA definition of Non-Reporting Canadian Financial Institution. But for the "other entity resident in Canada" language in the ITA, a non-reporting Canadian financial institution would have to be a "listed financial institution."

17 See Canada IGA Article 1(j) and FATF, "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation—The FATF Recommendation" (February 2012), www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf.

18 See Reg. 1.1471-5(e)(4)(i)(A).

19 The omission of the "primarily conducts as a business" requirement potentially raises the question whether certain entities in which the business activities secondarily include administering or managing funds on others' behalf were intended to result in a finding that such an entity (or one managed by it) is an Investment Entity under the Canada IGA.

20 See CRA Guidance, para. 3.21, and Example C in para. 3.27.

21 The leading Canadian case on whether securities are offered to the public is *R. v. Piepgrass*, [1959] 29 W.W.R. 218.

investment vehicle be managed by an entity that, as stated in paragraph (j), is authorized under Canadian provincial law to act as a dealer, investment advisor, fund administrator, fund manager, or portfolio manager. If the primary manager of an investment vehicle is not itself so authorized, will the requirement be satisfied if the manager enters into an investment management, sub-advisory, or administration agreement with a portfolio manager, investment advisor, or fund administrator that has the requisite provincial authorizations? In other words, would a portfolio manager, sub-advisor, or administrator that has a contractual relationship with the "primary" fund manager be considered to be managing the entity in determining if paragraph (k) is satisfied? That is somewhat unclear, although the inclusion of portfolio management, investment advising, and fund administration in paragraph (j) suggests that the concept of entity management in paragraph (k) is a broad one.

Another interpretive issue concerning the investment vehicle manager stems from the requirement that the manager be "authorized" under provincial legislation to engage in the enumerated activities. One possible interpretation of the authorization requirement is that under provincial securities or similar laws, the managing entity is registered as a dealer or advisor, for example, or acts under an applicable registration exemption. The CRA Guidance takes a broader view of what it means to be "authorized," saying that no registration is required and that an entity will have the requisite authorization so long as the provincial legislation "contemplates" any of the listed activities and the entity can perform one or more of them in the province (e.g., if it is exempt from a registration requirement).

The CRA Guidance regarding the meaning of "authorized" in paragraph (j) is helpful in the context of Canadian private equity. The expectation is that private equity fund partnerships managed in Canada will generally take the position that they are reporting Canadian financial institutions under Part XVIII of the ITA. The author understands that, as a securities law matter, the general industry position of Canadian general partners of private equity fund limited partnerships that are actively involved in the management of portfolio companies is that they are generally not engaged in activities requiring registration, so they are neither registered as fund managers (or otherwise) nor purporting to be acting under a registration exemption.[22] It seems that if the law of a particular province "contemplates" that an entity can act as a general partner of a limited partnership, and permits the entity to do what is required to manage a limited partnership engaged in investment activities without requiring registration under provincial law, the CRA would at least take the view that a general partner of a private equity fund limited partnership acting in that province has the requisite provincial law authorization to make the partnership a "listed financial institution" under the ITA.

New Kind of Hybridity

As should be evident from the discussion above, there is imperfect overlap between the concept of Investment Entity in the Canada IGA and the corresponding concept in the ITA, namely, paragraph (k) of the definition of "listed financial institution." For the most part, the latter is the narrower concept, which raises the issue of the status under the FATCA Regula-

[22] This industry position is supported by section I.3 of "Companion Policy 31-103CP Registration Requirements and Exemptions." The issue of whether registration is required would depend in part on the type of fund, with fund of funds or hedge funds making it more likely that the fund manager will be considered engaged in activities requiring registration.

[23] Unlike other defined terms used in this article, "Hybrid Canadian FI" is not used in any law/rule/IGA, but is created just for purposes of this discussion.

[24] See CRA Guidance, para. 3.28, which addresses the status of an entity that fails to qualify as both a Reporting Financial Institution and a "listed financial institution." The CRA says that such an entity "is a NFFE…(or, a nonreporting Canadian financial institution…)." The parenthetical reference to "nonreporting Canadian financial institution" should not be taken as an indication that a Hybrid Canadian FI might be a nonreporting Canadian financial institution. A Hybrid Canadian FI is defined herein as an entity that is Reporting Canadian Financial Institution under the Canada IGA but not a "listed financial institution" under the ITA. The parenthetical reference by the CRA (which was not in the June 23, 2014, initial release of the CRA Guidance) would seem to address the reverse scenarizo–an entity that does not qualify as a "listed financial institution" but does qualify as a Non-Reporting Canadian Financial Institution (for example, because it is a Canadian Financial Institution that is identified in Annex II of the Canada IGA). This would be consistent with ITA Part XVIII, under which, to qualify as a "non-reporting Canadian financial institution," an entity need not be a "listed financial institution." In other words, Canada does not intend that the narrowness of the "listed financial institution" definition in the ITA cause entities to fail to qualify for a beneficial status (nonreporting) under the Canada IGA and ITA.

[25] Reg. 1.1471-5(d).

[26] See Regs. 1.1471-5(e)(i) (definition of financial institution), 1.1471-1(b)(80) (definition of NFFE).

[27] Reg. 1.1471-1(b)(114).

[28] The requirement in the reporting Model 1 FFI definition that the foreign government has agreed to obtain and exchange information pursuant to a Model 1 IGA can be read as being more robust. An alternate reading is that the foreign government needs to have actually implemented domestic rules imposing on a reporting Model 1 FFIs in its jurisdiction the obligation to obtain and exchange the applicable information.

[29] See Reg. 1.1471-1(b)(80).

[30] If the Hybrid Canadian FI in fact does not technically qualify as a "listed financial institution" under Part XVIII of the ITA, its decision to engage in FATCA reporting may put it in a position where it is contravening the domestic privacy laws that Part XVIII was meant to override but without the protection of acting in compliance with Part XVIII.

[31] The author understands, based on anecdotal evidence only, that in light of the narrow scope of the "listed financial institution" category for investment vehicles and clear statements in the CRA Guidance, most trusts established for family estate planning purposes in Canada, whether or not they have professional management, are taking the position that they are NFFEs under Canadian law and not registering on the IRS portal. While entities taking that position would not perform their own due diligence and reporting to the CRA, they may have accounts with Canadian financial institutions that must apply a higher standard of due diligence to financial accounts held by passive NFFEs to identify their controlling persons and determine whether any such person is a U.S. resident or a U.S. citizen.

[32] See flush language at the end of Canada IGA Article 4(1), which requires the IRS to first notify the CRA of significant noncompliance by an entity, and then for at least 18 months to elapse without the noncompliance being resolved, before the IRS can treat the entity as nonparticipating.

[33] See Parillo, "Canada's FATCA Guidance: Too Much Discretion Used?," Tax Notes Today (July 9, 2014).

[34] See Bennett, "Treasury OK With Canadian Stance on Listed Financial Institutions Under FATCA," BNA Daily Tax Rep't, October 7, 2014, page G-4.

[35] An official of Canada's Department of Finance has also cited the reference to the FATF recommendations in the definition of "Investment Entity" as indicating that the Canada IGA intends to exclude private trusts from the definition. See DiSpalatro, "Canada's FATCA Legislation Could Irk Uncle Sam," advisor.ca, May 22, 2014 (www.advisor.ca/tax/tax-news/finance-bites-back-at- FATCA-criticism-148790). For a detailed criticism of the notion that the FATF recommendations can be used to support Canada's approach, see Berg and Barba, "FATCA in Canada: The Restriction on the Class of Entities Subject to FATCA," Canadian Tax J. (2014) 62:3, 587-633.

tions (Chapter 4 status) of an investment entity that for purposes of the Canada IGA is a Reporting Canadian Financial Institution but for purposes of the ITA is not a reporting Canadian financial institution because it is not a "listed financial institution." According to the CRA, such an entity ("Hybrid Canadian FI")[23] is an NFFE.[24] An example of a Hybrid Canadian FI would be a Canadian resident private investment trust that is a Financial Institution under the IGA but not a listed financial institution under the ITA. It is unclear whether the CRA is correct in asserting that such an entity is an NFFE when the frame of reference for construing the statement includes the Canada IGA and the FATCA Regulations. As defined in this article, a "Canadian Hybrid FI" is a Reporting Canadian Financial Institution under the Canada IGA and thus cannot be an NFFE for purposes of the Canada IGA, and while ITA Part XVIII modifies the meaning of certain Canada IGA terms when incorporated by reference into the ITA, it does not "reach into" the Canada IGA to change the meanings of terms therein. As discussed below, however, perhaps the CRA is referring to the Hybrid Canadian FI's overall Chapter 4 status, as defined in the FATCA Regulations, taking into account the applicable Model 1 IGA and the IGA partner's legislation.

The FATCA Regulations provide that an FFI includes any entity that is resident in a country that has in effect a Model 1 or Model 2 IGA and that is treated as an FFI pursuant to that IGA.[25] Based on its status under the Canada IGA, the Hybrid Canadian FI would appear to be an FFI under the FATCA Regulations, and if (as is assumed here) it is an investment entity for purposes of the FATCA Regulations, it will then be a financial institution and thus by definition not an NFFE (unless, as discussed below, it is treated as an NFFE under an IGA).[26] In addition, the Regulations generally define a "reporting Model 1 FFI" as an FFI with respect to which a foreign government agrees to obtain and exchange information pursuant to a Model 1 IGA.[27] Because the Hybrid Canadian FI is classified as a Reporting Canadian Financial Institution under the Canada IGA, it is arguably an entity with respect to which the Canadian government has committed to obtain and exchange information pursuant to a Model 1 IGA (notwithstanding that Canada's implementing legislation could be regarded as not following through on that commitment).[28] Thus, the Hybrid Canadian FI seemingly fits within the definition of a Reporting Model 1 FFI under the FATCA Regulations.

While the FATCA Regulations defer to IGAs to the extent of treating what otherwise would be an FFI as an NFFE if the entity is treated as an NFFE in an IGA,[29] we have concluded that a Hybrid Canadian FI is not an NFFE within the meaning of the Canada IGA, and the FATCA Regulations do not go so far as to provide that an NFFE includes any foreign entity treated as an NFFE under the domestic laws of an IGA partner. That said, and as discussed below, it may be that the IRS will defer to determinations of Chapter 4 status under local laws implementing an IGA.

That the CRA would declare a Hybrid Canadian FI to be an NFFE, while such an entity seemingly remains a financial institution under Chapter 4, puts the entity in a difficult place in terms of compliance. In Canada, the Hybrid Canadian FI may find it attractive, particularly if it is not controlled by U.S. residents or citizens, to accept the less onerous path laid out for it under the ITA and the CRA Guidance, i.e., taking the position that it is not a reporting Canadian financial institution. However, when it comes to certifying its Chapter 4 status on a Form W-8 under penalty of perjury, using terms that have meanings laid down by U.S. law, the entity understandably may hesitate to certify that it is a (passive or active) NFFE.

It would appear that different approaches have been adopted in the face of the compliance quandaries facing Hybrid Canadian FIs. There is margin for judgment and flexibility in approach since an entity may find itself a possible Hybrid Canadian FI as result of arguable conflicts between rules that are somewhat ambiguous and, in any event, not yet subject to longstanding administrative guidance. In this light, even if the ITA might be read as not treating the entity as a Canadian financial institution subject to reporting obligations, one approach that some entities are adopting is to (1) register on the IRS portal as a reporting Model 1 FFI; (2) fully comply with the due diligence and reporting obligations imposed under the ITA and Canada IGA on reporting Canadian financial institutions;[30] and (3) state on Forms W-8 that the entity is a reporting Model 1 FFI.[31] A variant of this approach would be for an entity to take steps (1) and (3) but not (2), that is, to treat itself as a Reporting Canadian Financial Institution without in fact doing any reporting. A Hybrid Canadian FI adopting the latter approach may seek to rely on language in Article 4(1) of the Canada IGA stating that even if a Reporting Canadian Financial Institution does not in fact comply with basic reporting obligations that the Canada IGA attaches to that status, the entity will not be subject to FATCA withholding unless and until the IRS affirmatively declares the entity to be a Nonparticipating Financial Institution.[32]

Yet another position being adopted with respect to Hybrid Canadian FIs is that the instructions to Form W-8BEN-E (Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities)) can be read as indicating that the IRS wants foreign entities to determine their Chapter 4 status based on their local-country implementing legislation,[33] arguably even when the resulting classification may be inconsistent with the classification under the FATCA Regulations. Based on that position, another possible approach would be for the Hybrid Canadian FI to take the stand that it is an (active or passive) NFFE not just vis-a-vis the CRA for domestic FATCA reporting purposes, but also when certifying its status to U.S. withholding agents and other FFIs. Those adopting this compliance posture may also seek to derive comfort from the above-mentioned language in Article 4(1) of the Canada IGA regarding Reporting Canadian Financial Institutions that do not comply with the reporting obligations in the Canada IGA for entities having that status.

A U.S. withholding agent obtaining a withholding certificate and an FFI collecting accountholder information may not, without further inquiry, rely on payee or accountholder documentation if the withholding agent or FFI has "reason to know" that the information provided is unreliable or incorrect. Accordingly, in choosing a compliance approach, a Canadian Hybrid FI should be mindful that questions may be raised when the expectations of a withholding agent or FFI as to an entity's Chapter 4 status are inconsistent with the status reported by the entity.

There is some indication that Treasury will not be opposing the approach to Investment Entities adopted in Canada's implementation of the Canada IGA.[34] Speaking at a public FATCA symposium on October 6, 2014, Brett York, an Attorney-Advisor in Treasury's Office of International Tax Counsel, was asked about Canada's exclusion of private trusts from the definition of "listed financial institution" (and thus from the Canadian domestic concept of a reporting Canadian financial institution). York said that Treasury had given a lot of thought to Canada's narrowing of the scope of what counts as a financial institution through its listed financial institution category in the ITA, and that Treasury was "okay with this interpretation in the context of the Canadian IGA." York referred to the cross-reference in the Canada IGA definition of Investment Entity to the FATF recommendations as in some way explaining Treasury's acceptance of the Canadian approach, although the reasoning offered as to the relevance of the FATF recommendations was somewhat opaque.[35] York was not asked, so it is unclear, whether Treasury's benign acceptance of Canada's narrowing of the Financial Institution concept in the case of private trusts would extend to other types of Financial Institutions that Canada has excluded from domestic FATCA reporting obligations through the ITA "listed financial institution" concept. Put another way, it may be going too far to interpret these initial comments from Treasury as signalling that it has decided that its public position is that now all Hybrid Canadian FIs can simply choose NFFE as their Chapter 4 status.

There is an additional, though far less problematic, way in which an entity could be classified inconsistently under the Canada IGA and the "listed financial institution" definition in the ITA. An entity that fits in one of the categories of "listed financial institution"—for instance, a "loan company regulated by a provincial Act" (paragraph (i) of the definition)—could, based on its facts, not qualify as any type of Financial Institution in the Canada IGA (for example, not a Depository Institution or Custodial Institution). If it indeed does not qualify as a Financial Institution for purposes of the Canada IGA, such a "listed financial institution" would be classified the same way under the Canada IGA and the ITA, since a reporting Canadian financial institution under the ITA must qualify as a Financial Institution under the Canada IGA, in addition to being a "listed financial institution."

Conclusion

While this article has noted gaps and inconsistencies between Canada's implementing legislation on one hand, and the FATCA Regulations and Canada IGA on the other, it is at least equally important to emphasize that for most types of Canadian investment entities, there will be little uncertainty or inconsistency with respect to their status under ITA Part XVIII, the FATCA Regulations, and the Canada IGA. For example, a mutual fund or ETF in which investments are managed by an entity that is registered in a province as a portfolio manager or investment fund manager, as well as the manager itself, will be a reporting Canadian financial institution under the ITA and the Canada IGA and, on registering on the IRS FATCA portal, a reporting Model 1 FFI under the FATCA Regulations. Thus, the entity will clearly be a registered deemed-compliant FFI under the Regulations that will have reporting obligations to the CRA but will not have to enter into an FFI Agreement with, or do information reporting directly to, the IRS. However, for certain Canadian investment entities (Hybrid Canadian FIs herein), this clarity is lacking and there are judgment calls to be made in terms of their Chapter 4 status and resulting compliance duties. These entities will perhaps be emboldened by recent favorable signals from Treasury to rely on the CRA Guidance to select their Chapter 4 status and domestic reporting posture, and pay less regard to contrary indications in the FATCA Regulations or the Canada IGA. ●