ASSOCIATION DES BANQUIERS CANADIENS
CANADIAN BANKERS ASSOCIATION

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Dear Ms. Corwin and Messrs. Shay, Danilack, and Musher:

Re: Comments on Foreign Account Tax Compliance Act Provisions Incorporated In the Hiring Incentives to Restore Employment Act

The Canadian Bankers Association (CBA) welcomes the opportunity to provide input to the United States Internal Revenue Service (IRS) and Treasury as officials consider how to draft regulations to operationalize Chapter 4 under Subtitle A of the Internal Revenue Code ("Taxes to Enforce Reporting on Certain Foreign Accounts").

The CBA works on behalf of 51 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 263,400 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions.

It should be noted that the issues raised in this letter and the recommendations made herein should not be considered to be exhaustive. Individual Canadian banks may have additional issues that they would like to raise with the IRS and Treasury based on their particular business practices and systems. In addition, it should also be noted that a number of other well-considered submissions have been made by organizations such as the Institute of International Bankers (IIB) and European Banking Federation (EBF), and the British Bankers Association which raise additional issues that the IRS and Treasury should consider when developing regulations to implement Chapter 4.

Canadian bank financial groups play two roles, both of which need to be understood when considering the impact of Chapter 4 – they are the largest provider of financial products and services to millions of Canadian residents, and they are international financial services firms with operations in over 60 countries worldwide.

Bank Financial Groups Play a Key Role in the Canadian Financial Sector

The vast majority of Canadians have some relationship with one or more of Canada's major bank financial groups. Consider the following:

- Canada has one of the highest rates of bank account ownership in the world. Statistics indicate that 96% of working age Canadian residents, or approximately 27 million Canadians, have a retail bank account. The majority of those people will hold their account with a major Canadian bank. Banks in total account for 84% of total Canadian deposits in Canada and 75% of retail deposits. Most of that total is accounted for by the six major banks. Canada's six major banks account for 91% of total deposits held by Canadian banks.
- Canada's major bank financial groups have a substantial presence in the securities brokerage industry, accounting for approximately 72% of trading revenue in Canada.
- The major bank financial groups also have a strong presence in the Canadian mutual fund industry, collectively accounting for 38% of total Canadian mutual fund assets under management.
- Canadian banks are also the principal supplier of business financing in Canada, accounting for 69% of total debt financing provided to businesses in Canada in 2008.

The reason that I highlight these statistics is not to boast about the success of the banking industry in providing products and services to Canadians but rather to put in context the challenge that Chapter 4 places on Canadian banks. Put simply, asking Canadian banks to identify, with clinical precision, every U.S. person (citizen, green card holder, or otherwise) who has some relationship with a Canadian bank financial group, either directly or by virtue of their having a significant interest in a private corporation or other entities, is tantamount to asking those banks to undertake a census of Canada. It is not feasible. Canadian bank financial groups want to work with the IRS and Treasury and fully appreciate the legislation's objective of ensuring that U.S. persons comply with U.S. tax laws, but reasonableness and flexibility on the part of U.S. regulators will be required in order to put Canadian financial institutions in a position where they can sign an agreement that would assist the IRS and Treasury in doing that. It is in that spirit of cooperation and reasonableness that the CBA has developed the recommendations that are outlined below.

Chapter 4 and its Application to Domestic Retail Banking

Chapter 4 seems to be borne in part out of the experiences of the Qualified Intermediary (QI) program and draws some of its intellectual underpinnings from that program. However, that foundation has limitations. The QI program focuses on the identification of U.S. and non-U.S. persons receiving U.S. source income and ensuring that those amounts are subject to the correct rate of U.S. withholding and that the amounts are correctly reported to the IRS. Typically, the QI will be that part of the financial institution that receives U.S.-source income on behalf of its client, usually in the securities industry. Since these people may be receiving U.S.-source payments, they have a clearer incentive to voluntarily provide the QI with information about their

citizenship to reduce withholding. This "carrot-stick" model of obtaining information works in this context because the client typically has a clearer incentive to comply and is sufficiently financially sophisticated to evaluate the consequences of not voluntarily providing the information.

Taking this model and trying to apply it to a retail banking environment opens up a whole set of new issues that were never contemplated in the QI program and that are only now coming to light as banks explore this issue. Bank clients are very different from brokerage clients.

- There are many more of them. Approximately 96% of Canadians have a bank account but far fewer hold securities.
- They are far more varied in their profile. A deposit account is a mass-market financial product so it captures all social strata and all levels of financial sophistication.
- They use their accounts differently. They use it to deposit their paycheque, pay their bills, buy groceries using their debit card, write cheques for their rent, and generally help them manage their daily life.

Because retail bank accounts play such a central role in people's daily life, public authorities often regard them as a required element for social inclusion. In Canada, they have gone a step further and instituted legislation that requires banks to open accounts for all residents who present a minimum level of identification stipulated in regulation. Section 448.1 of the *Bank Act* reads as follows:

> 448.1 (1) Subject to regulations made under subsection (3), a member bank **shall**, at any prescribed point of service in Canada or any branch in Canada at which it opens retail deposit accounts through a natural person, open a retail deposit account for an individual who meets the prescribed conditions at his or her request made there in person.

The conditions are prescribed in the *Access to Basic Banking Services Regulation* (attached in Attachment 2). The combination of Section 448.1 plus the regulations effectively mandate that Canadian banks must open accounts for Canadian residents (citizens or otherwise) who provide identification from a prescribed list, with the only exceptions being for instances where the bank either suspects that the identification is fraudulent or that the account is being used for illegal activities (see Attachment 3 for a plain language description of Access to Basic Banking that was published by the federal Financial Consumer Agency of Canada). Our understanding is that similar measures are in effect in many other developed countries (e.g. France, Belgium, Ireland)[1] and are being considered in others such as the UK. These types of regulatory requirements place banks in a challenging position with respect to identification and account closing provisions in Chapter 4.[2]

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[1] In Ireland, the Government made provision of a basic bank account to all residents a requirement of the banking recapitalization program. Belgium and France have legislation providing residents with a right to a bank account. For more details, see European Commission, *Ensuring Access to a Basic Bank Account.* (http://ec.europa.eu/internal_market/consultations/docs/2009/fin_inclusion/consultation_en.pdf)

[2] While there is no technical restriction in the *Bank Act* with respect to account closures, section 448.1 of the *Bank Act* plus the associated regulation mean that banks would be obligated to re-open accounts for those who requested that they do so.

More generally, the view of "retail accounts as public necessities" is present throughout the developed world. For example, even within the United States, the State of New York has a requirement that banks must make available a basic bank account to all residents.[3] All of this suggests that if banks were to start restricting access to retail bank accounts for no reason other than the account holder (or, in the case of a small business, the owners of the business) refuses to identify their citizenship and/or will not consent to having their account information transferred to the IRS, this would likely draw a strong response from domestic legislators and regulators making compliance with Chapter 4 even more problematic.

And this is on top of the civil law risks that accompany account closing since closing an account will almost always have ripple effects of missed payments and, in the case of a business, potentially imperil its operations.

We are concerned that the unique features of the legislative and regulatory environments for banking were not fully considered during the drafting of the legislation. That is understandable because the legislation was built from the framework of the QI regime, which is largely securities-based. Since a securities account is not typically considered by policy makers to be a requirement to participate in society, typically there is no domestic legislation obligating service. Likewise, since securities investors are more likely to invest in U.S. assets, there is some expectation that relief from withholding would be an incentive to investors to comply.

The vast majority of retail bank clients are clearly not the people that the legislation is intended to target; however, by scoping them in, the legislation inadvertently scopes in literally millions of middle class and working class people who have no connection to the U.S., no U.S.-source income that could be subject to withholding and who, in some cases, have a legislated right to open an account. Therefore, the IRS and Treasury run the risk that significant numbers of institutions may be unable to enter into agreements with the IRS or, if they do, may inadvertently abrogate their agreements because Chapter 4 may not afford the flexibility necessary to meet its terms while still meeting their domestic banking legislative requirements. The reality is that "obligation to serve" legislation is simply the most obvious of a series of issues that are likely to arise as firms study the challenges of applying Chapter 4 conditions to a retail banking regulatory and business environment.

All of this points to the need to **review whether and how Chapter 4 should apply to retail banking.** The inclusion of the US$50,000 exemption suggests that there is an intent in the legislation to carve out small-value deposit accounts. While that exemption may help to sidestep some of these problems in some instances if it is made sufficiently flexible (and recommendations on that are included below), it is not a complete solution. A more fulsome and lasting solution must be found if Chapter 4 is to be a success.

Identifying the Citizenship of Account Holders

As the EBF and the IIB have highlighted in their submission dated April 23, 2010, the concept of documenting the citizenship of all current and future account holders is one of the most challenging legal and logistical elements of Chapter 4. As noted above, in the Canadian case if taken to its logical extreme that would effectively involve a census of the entire population

[3] See State of New York Banking Department "Basic Bank Accounts". (http://www.banking.state.ny.us/brbba.htm)

of the country, which simply is not feasible. We support the proposals put forward by the EBF and IIB in this regard, since they would go some way to making this requirement manageable, especially as they pertain to existing account holders. However, even with the EBF and IIB proposals, there are still challenges that should be understood and additional clarifications that should be introduced to address both the ability of Canadian bank financial groups to enter into foreign financial institution (FFI) agreements and the compliance burden that any potential agreement creates, both for the bank and for the IRS.

The reality is that it is likely that relatively few retail bank accountholders in Canada are going to be U.S. persons and, of those, few if any of them would represent a source of significant lost tax revenue to the U.S. since they would generally be subject to income tax in Canada at a rate higher than that of the U.S. If one accepts that that is the case then it stands to reason that it is in everyone's interest that **the IRS and Treasury utilize the flexibility afforded by its regulatory discretion under Chapter 4 to minimize the instances where documentation is required from groups that clearly present a low risk of tax evasion.**

Clarifying and Improving the $50,000 Exemption

It is reasonable to assume that the intent of the exemption from identification and reporting obligations for deposit account holders with aggregate balances of less that US$50,000 [section 1471(d)(1)(B)] is to do exactly what is described above -- carve out from Chapter 4 those account holders who clearly represent a low risk of tax evasion. If properly implemented, this provision may help to achieve that objective; however, regulators must ensure that it is made sufficiently flexible to allow financial institutions to make use of it.

As a first order, in order to be operationally feasible for almost any firm given the systems constraints that banks face, Treasury must **refrain from exercising the option contained in this subsection that would allow it to treat members of the affiliated group as a single entity for the purposes of evaluating the US$50,000 exemption.** Canadian bank financial groups operate on a universal banking model with global operations. Requiring aggregation of deposits across affiliates would make it effectively impossible to use this provision because systems are simply not sufficiently interconnected and robust to provide that type of single-client evaluation. Legal restrictions also prevent the sharing of information between legal entities without client consent, adding yet another dimension of complexity to aggregation. Without a reasonable level of comfort that aggregation across affiliates would not generally be required, many banks may not be prepared to incur the costs associated with making the changes necessary to aggregate deposit accounts within a single legal entity for purposes of measuring the US$50,000 threshold on an ongoing basis, and even with such assurances there is still no guarantee that this exclusion can be cost effectively operationalized.

An even more effective step would be to **relax the requirement that banks aggregate deposit accounts to assess the US$50,000 cap and simply treat any account of under US$50,000 as being exempted from the definition of a "United States Account" and exempt from any requirement to identify the status of the account holder.** This would go some way towards addressing the retail banking challenges articulated earlier in the letter (although, as noted, it would not fully resolve them). It is also unlikely to create a material loophole in the legislation since it would seem highly unlikely that anyone would set up a series of small-value deposit accounts at one financial institution to evade Chapter 4 reporting requirements.

Exempting Registered Products

Like the U.S. government, the Canadian government has made it a priority to provide Canadian residents with incentives to save for their retirement and other future necessities such as health and education. In both countries, governments have used tax policy as a tool to help achieve that public policy goal by establishing a series of savings products registered with tax authorities that residents can use to build retirement savings. In the U.S., the Government has established Investment Retirement Accounts (conventional and Roth) to encourage private retirement savings; in Canada, the government has established Registered Retirement Savings Plans (RRSPs) and Registered Retirement Income Funds (RRIFs). The Canada-U.S. Tax Treaty recognizes the similarity of the products, both in design and intent, and classifies all of them as pensions for the purposes of the Treaty. Chapter 4 acknowledges the unique status of personal retirement savings products. Section 1473(3) exempts "individual retirement plans" from the definition of "specified United States person" and, by extension, from the definition of "United States account". While we take this to mean U.S. individual retirement plans, **the CBA believes that in light of the fact that these retirement savings products are afforded special treatment under the Canada-U.S. Tax Treaty and since these are registered plans that present no risk of being used as a tool for tax evasion, the IRS and Treasury should use its discretion to carve out RRSPs and RRIFs.**

As in the case of retirement savings, the Government of Canada has created tax-advantaged registered savings products to assist Canadian residents to achieve other socially desirable objectives such as saving for education and providing financial assistance to people with disabilities -- Registered Education Savings Plans (RESPs), Registered Disability Savings Plans (RDSPs), as well as the general-purpose Tax-Free Savings Accounts (TFSAs). Again, these are registered with Canadian tax authorities and are targeted at middle-class Canadian residents, and therefore pose no risk of being used as tools for U.S. tax evasion but do serve a very important public policy objective shared by both of our Governments. Therefore, **the CBA recommends that the IRS and Treasury use its discretion to also exempt RESPs, RDSPs, and TFSAs from the definition of "financial account".** Details of all of the registered products available in Canada are included in Attachment 4. [4]

Clarifying the Recalcitrant Account Holder Provisions

As noted earlier, **the CBA supports the proposal by the EBF and IIB that an automated search of existing client information databases held by financial institutions to identify indicia of U.S. personage, and follow-up only with those persons who are identified as potential U.S. persons, be sufficient for the purposes of meeting the terms of Chapter 4 as it pertains to existing client accounts.**

Our understanding of Chapter 4 is that in the instance that an accountholder is identified as a U.S. person then the financial institution must obtain a waiver of any restrictions that would otherwise prevent the institution from transferring that person's account information to the IRS or, if the client refuses to grant such a waiver, close the account. This places Canadian banks in a very difficult position since, under *Access to Basic Banking Services Regulations*, as long as the

[4] Further information on these and other registered savings products can be found on the Canada Revenue Agency website at http://www.cra-arc.gc.ca/tx/rgstrd/menu-eng.html.

individual presents the prescribed identification and is not suspected of fraud or criminal activity, the bank is obligated to open an account that offers at least a minimal level of service.

It should also be understood that even withholding 30 percent in a retail banking context can be problematic. In many cases, when an individual deposits a U.S. source payment (e.g. a check or a wire payment) into his/her account, the bank will have no way of knowing whether this constitutes a withholdable payment because the bank has no relationship with the payor and has no knowledge of the reason that the payment is being made. Under those conditions, the bank cannot establish whether the payment represents FDAP income and/or proceeds from the sale of a U.S. asset, or whether it is for some other purpose entirely. This is yet another example of the complexity of trying to apply Chapter 4 to a retail banking environment.

Therefore, the CBA supports the recommendation of the EBF and IIB to find alternatives to closure in situations such the one described above and that, where withholding is required, latitude be provided through regulation. We further recommend that the IRS and Treasury refrain from making any further demands on financial institutions in the case of new account applicants who do not provide sufficient information for purposes of allowing the financial institution to confirm if the account is a United States account.

Disaggregating the Financial Groups

Perhaps the greatest challenge that Chapter 4 presents over the existing Qualified Intermediary program is the requirement that the entire affiliated financial group comply with the terms of the FFI agreement. Our understanding is that the intent of the legislation is that all financial institutions that are members of the same expanded affiliated group must identify and report United States Accounts, but that within the affiliated group individual financial institutions can enter into their own FFI agreements with the IRS. Regardless of whether an affiliated group enters into a single or multiple FFI agreements, as mentioned by the IIB and EBF, **the guidance should permit different entities, divisions or locations within an affiliated group to file separate annual reports with the IRS. Similarly, a single entity should not be required to consolidate reporting information that originates from separate data systems.** For many FFIs, requirements to aggregate information would create significant additional cost burdens.

As noted earlier, Canadian bank financial groups do business in over 60 countries. That means that in order to avoid the 30 percent withholding tax outlined in Chapter 4, Canadian bank financial groups will need to ensure that they can successfully enter into agreements with the IRS that can be complied with in 60 different legal and regulatory systems. While there is always a temptation to attribute local legislative roadblocks to issues such as bank secrecy laws or other similar measures and therefore say that these are effectively the problems that Chapter 4 is meant to address, reality is far more complex than that. As discussed above, invariably, there will be instances where well-meaning local legislation creates a roadblock to meeting the terms of Chapter 4, whether it is "obligation to serve" legislation or other issues that have yet to be unearthed. The blanket requirement that *all parts of the affiliated financial group meet the terms of Chapter 4 or else all are subject to withholding* runs the risk of putting institutions in the position of being unable to enter into an agreement with the IRS, and therefore having to withhold on their worldwide customer base, because of problems in a few jurisdictions. This would not be in the interest of the IRS or the financial group because it would invariably result in large numbers of overwithholding claims from clients in the rest of the financial group and would

deter institutions from entering into agreements in the first place. Therefore, **the CBA recommends that the IRS and Treasury utilize their regulatory authority to provide that the terms on the FFI agreement need not apply to those parts of the affiliated financial group that cannot enter into an agreement with the IRS because of conflicts with domestic legislation.** This is especially true in the case of jurisdictions that have tax treaties or tax information exchange agreements with the United States.

Chapter 4 as part of the Canada – United States Relationship

Beyond the specific issues raised above, we believe that the unique relationship that Canada and the United States enjoy should be considered by the IRS and Treasury as it drafts the regulations that will give effect to Chapter 4. The United States Joint Committee on Taxation described well the extent of the relationship:

> The value of trade between the United States and Canada is large. In 2007, the United States exported $248.9 billion of goods to Canada and imported $317.1 billion in goods from Canada. These figures made Canada the United States' leading goods export destination and the second largest source of imported goods. These figures also represent 21.7 percent of all goods exports from the United States and 16.1 percent of all imports into the United States. Similarly, the value of cross-border investment, U.S. investments in Canada, and Canadian investments in the United States is large. In 2007, U.S. investments in Canada increased by $67.2 billion and Canadian investments in the United States increased by $73.7 billion. The increase in Canadian-owned U.S. assets represents approximately 3.6 percent of the increase in all foreign-owned assets in the United States in 2007.[5]

As a consequence of this unique relationship, Canada and the United States have developed one of the most comprehensive tax treaties in the world, making it virtually impossible to shelter income from taxation. The Canada-U.S. Tax Treaty provides for automatic reporting to the IRS by the Canada Revenue Agency (CRA) of virtually all taxable income where the recipient has a U.S. address[6] and where the CRA uncovers any financial information that may be relevant to the IRS as part of an audit. Moreover, Canada and the U.S. also have similar tax systems and rates of taxation. The combination of the extensive information sharing associated with the tax treaty and the similar tax regimes means that there is no incentive for residents of either country to use the other as a tool for tax evasion. Given the strength, depth, and history of this relationship, and the strength of the institutional arrangements that help govern it, it follows that **the IRS and Treasury should provide exceptional latitude in the application of Chapter 4 to Canadian institutions and Canadian residents (citizens or otherwise), and consider**

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[5] U.S. Joint Committee on Taxation, *Explanation of the Proposed Protocol to the Income Tax Treaty between the United States and Canada.* July 8, 2008. p. 21. (http://www.jct.gov/x-57-08.pdf)

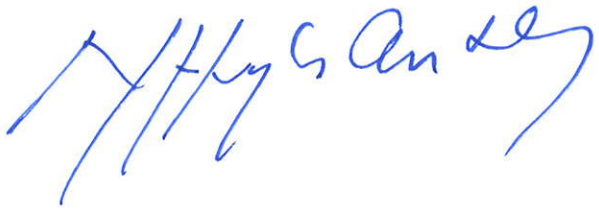
[6] Includes the following income documentation: Statement of amounts paid to non-residents (NR4), Statement of Fees, Commissions, or other amounts paid to non-residents for services rendered in Canada (T4A-NR), Employment Income (T4), Statement of Pension, Retirement, Annuity and Other Income (T4A), Statement of Old Age Security (T4(OAS)), Statement of Registered Retirement Savings Plan Income (T4RSP), Statement of Income from a Registered Retirement Income Fund (T4RIF), and Statement of Investment Income (T5).

broader exemptions for Canadian financial institutions, since to do otherwise would risk damaging the longstanding, mutually-beneficial relationship that our two countries enjoy.

In closing, I would like to reiterate that while the recommendations included in this letter (summarized in Attachment 1), and issues raised in this letter, are important for all Canadian banks, this should not be considered to be exhaustive treatment of the issue. With legislation as all-encompassing as Chapter 4, it is impossible to undertake an exhaustive treatment of the issue in the short amount of time that has passed since passage of the legislation. Individual Canadian banks may have additional issues that they would like to raise with the IRS and Treasury based on their particular business practices and systems as they undertake their analysis of the legislation.

I would be pleased to speak with you further about this important topic.

Sincerely,



Attachments (4)