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FATCA and FBAR Reporting by Individuals: Enforcement Considerations from a Canadian Perspective

Andrew Bonham*

PRÉCIS

Au cours des derniers mois, la presse générale canadienne a tenu des propos de plus en plus alarmistes au sujet des exigences de déclaration des actifs à l'étranger qui s'appliquent aux contribuables américains tant aux termes de la *Bank Secrecy Act of 1970* des États-Unis (la déclaration « FBAR » ou « *Report of Foreign Bank and Financial Accounts* ») que des exigences personnelles de déclaration nouvellement promulguées en vertu de la *Hiring Incentives To Restore Employment Act of 2010* des États-Unis (la déclaration « FATCA » ou « *Foreign Account Tax Compliance Act* »). Ces exigences de déclaration inquiètent particulièrement les particuliers vivant au Canada qui sont assujettis à ces lois du seul fait qu'ils détiennent la citoyenneté américaine ou une carte verte. Si la déclaration FBAR est en vigueur depuis plus de 40 ans, ce n'est que récemment que le gouvernement américain a considérablement accru ses efforts de mise en application, lançant une campagne de sensibilisation du public et offrant une amnistie partielle à ceux qui déclarent volontairement leur non-conformité à la FBAR. Depuis la promulgation du régime de la FATCA, les inquiétudes se sont mutées en quasi-panique, car les résidents du Canada visés par les règles tentent d'y voir clair avec les rapports (certains factuels, d'autres pas) provenant d'une multitude de sources au sujet des pénalités potentiellement sévères imposées en cas de non-conformité à l'un ou l'autre des ensembles d'exigences de déclaration.

Cet article examine les lois FBAR et FATCA en vue de déterminer si leurs dispositions punitives peuvent être mises en application au Canada, que ce soit par les tribunaux ou par l'entremise des dispositions d'assistance en matière de perception de la convention fiscale Canada–États-Unis. Il est à espérer que cette analyse rassérénera les citoyens américains et les titulaires de carte verte vivant au Canada qui se conforment par ailleurs à leurs obligations fiscales. L'auteur trace d'abord les grandes lignes de l'origine et de la nature des obligations de déclaration aux termes de la FBAR et de la FATCA. Il passe ensuite en revue les règles de *common law* contre la mise en application de lois

* Of Cunningham Swan Carty Little & Bonham, LLP, Kingston, Ontario (e-mail: abonham@cswan.com).

sur le revenu et de lois pénales étrangères ainsi que la tendance grandissante vers la reconnaissance des jugements étrangers par les tribunaux canadiens. Il traite également des considérations constitutionnelles, dans la mesure où elles peuvent influer sur le caractère exécutoire, et des principes de l'interprétation des conventions. Il conclut que, du moins à l'heure actuelle, aucune pénalité résultant de la non-production de déclarations FBAR et/ou FATCA ne serait exécutoire au Canada. En outre, il se demande si le gouvernement américain devrait diminuer ses efforts de mise en application en ce qui a trait aux contribuables américains vivant au Canada. Il laisse entendre que cela est improbable, compte tenu que la FATCA semble avoir été conçue de sorte à faciliter la perception des revenus sous forme d'amendes et de pénalités ainsi qu'à remplacer la FBAR par une loi ayant une plus grande probabilité d'exécution dans les pays étrangers.

MOTS CLÉS : FATCA ■ FBAR ■ CONFORMITÉ ■ MISE EN APPLICATION ■ CONVENTIONS FISCALES ■ INTERNAL REVENUE SERVICE

ABSTRACT

In recent months, the popular press in Canada has taken an increasingly alarmist view of the offshore asset reporting requirements applicable to US taxpayers under both the US Bank Secrecy Act of 1970 (the "FBAR," or Report of Foreign Bank and Financial Accounts, disclosure) and the newly enacted individual reporting requirements under the US Hiring Incentives To Restore Employment Act of 2010 (the "FATCA," or Foreign Account Tax Compliance Act, disclosure). These reporting requirements are of particular concern to individuals living in Canada who are subject to these laws solely by virtue of their US citizenship or green-card status. While FBAR reporting has been in place for more than 40 years, it is only recently that the US government has significantly stepped up its enforcement effort, by launching a public awareness campaign and offering partial amnesty in exchange for voluntary disclosure of FBAR non-compliance. With the enactment of the FATCA regime, the concern has intensified to near-panic as residents of Canada to whom the rules apply grapple with reports—some factual and some not—from a myriad of sources regarding potentially severe penalties for non-compliance with either or both sets of reporting requirements.

This article examines the FBAR and FATCA laws with a view to determining whether their punitive provisions can be enforced in Canada, either in the courts or by way of the assistance-in-collection provisions of the Canada-US tax treaty. It is hoped that this analysis will provide some comfort to US citizens and green-card holders living in Canada who are otherwise tax-compliant. The author first outlines the origin and nature of the FBAR and FATCA reporting requirements. He then reviews the common-law rules against enforcement of foreign revenue and penal laws, and the increasing trend toward the recognition of foreign judgments by Canadian courts. He also addresses constitutional considerations, insofar as they may affect enforceability, and principles of treaty interpretation. He concludes that, at least at present, no penalties arising out of failure to remit FBAR and/or FATCA returns would be enforceable in Canada. He also considers whether the US government might relax its enforcement effort with respect to US taxpayers living in Canada. He suggests that this is unlikely, given that FATCA appears to be designed to facilitate the collection of revenue in the form of fines and penalties, and to replace FBAR with a law that has a greater chance of enforceability in foreign jurisdictions.

KEYWORDS: FATCA ■ FBAR ■ COMPLIANCE ■ ENFORCEMENT ■ TAX TREATIES ■ INTERNAL REVENUE SERVICE

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INTRODUCTION

Since the early spring of 2011, the popular Canadian press has carried numerous reports regarding compulsory US tax filings by individuals residing outside the United States in connection with assets held in Canada and other foreign jurisdictions.[1] These mandatory filings apply to all individuals who are subject to tax under US law, regardless of where they live.[2] Accordingly, the asset reporting regime applies not only to expatriate US citizens but also to many green-card holders who have permanently left the United States to reside elsewhere, even though their green card may have expired as a result of their prolonged absence from the United States.[3]

1 See, for example, Jamie Golombek, "Americans Among Us," *National Post*, July 30, 2011.

2 See Treas. reg. section 1.1-1(b) to the Internal Revenue Code of 1986, as amended.

3 What is often not understood is that individuals who in the past obtained a US green card, and as a result were considered to be resident aliens for US income tax purposes (and therefore required to file US tax returns on their worldwide income), may well continue to be so considered even after they have permanently left the United States. In this regard, Treas. reg. section 301.7701(b)-1(b) states: "(b) *Lawful Permanent Resident*—(1) *Green Card Test*. An alien is a resident alien with respect to a calendar year if the individual is a lawful permanent resident

While the filing requirement has existed for many years, it has recently been transformed into a major issue as a result of an intensified enforcement effort by the US government, and the media attention that this initiative has attracted. The public furor in Canada has grown in intensity as the rumour mill has fed the anxiety of individuals who were previously unaware of the requirement or of the consequences of failure to file. Stories have circulated—not all of them accurate—regarding potentially severe civil and criminal penalties for non-compliance, creating a sense of near-panic and uncertainty about possible exposure to enforcement action by the Internal Revenue Service (IRS).

The initial wave of concern appears to have arisen from the announcement by the commissioner of the IRS of the "offshore voluntary disclosure initiative" (OVDI) in February 2011.[4] OVDI was aimed at addressing the issue of non-compliance with the reporting requirements under the Bank Secrecy Act of 1970[5] (BSA) (referred to as the FBAR[6] requirements). It was based on a similar program that had been introduced in 2009, and its purpose was essentially the same: to recover offshore money owing to the US tax system. More particularly, as stated in a subsequent IRS release, the objective of OVDI was "to bring taxpayers that have used undisclosed foreign accounts and undisclosed foreign entities to avoid or evade tax into compliance with United States tax laws."[7] To this end, OVDI offered partial amnesty to taxpayers who came forward voluntarily to remedy their non-compliance. The initiative was initially set to expire on August 31, 2011 but subsequently extended to September 9, 2011.

Along with the IRS's renewed focus on FBAR compliance, another set of similar reporting requirements looms on the horizon. In the not too distant future, US taxpayers will be subject to new provisions embedded within the Internal Revenue Code[8] (IRC) that require disclosure of certain foreign assets to the IRS. This second

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at any time during the calendar year. A lawful permanent resident is an individual who has been lawfully granted the privilege of residing permanently in the United States as an immigrant in accordance with the immigration laws. *Resident status is deemed to continue unless it is rescinded or administratively or judicially determined to have been abandoned* [emphasis added]." See also United States, Department of the Treasury, *Income Tax Compliance by U.S. Citizens and U.S. Lawful Permanent Residents Residing Outside the United States and Related Issues* (Washington, DC: Department of the Treasury, Office of Tax Policy, May 1998), at 44.

4 Internal Revenue Service, "Second Special Voluntary Disclosure Initiative Opens; Those Hiding Assets Offshore Face Aug. 31 Deadline," *News Release* IR-2011-14, February 8, 2011.

5 31 USC 1051 et seq. The BSA is also known as the Currency and Foreign Transactions Reporting Act, the anti-money-laundering law (AML), or sometimes BSA/AML. See I. Nelson Rose, "Treasury Expands Casino Reporting, Again" (2011) 15:4 *Gaming Law Review and Economics* 167-71.

6 The term "FBAR" is derived from the title of Treasury department form TD F 90-22.1 "Report of Foreign Bank and Financial Accounts," required to be filed under the BSA.

7 Internal Revenue Service, "2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers," August 26, 2011, at question 2 (www.irs.gov/businesses/international/article/0,,id=235699,00.html).

8 Supra note 2.

set of disclosure requirements arises out of the recently enacted Foreign Account Tax Compliance Act[9] (FATCA).

As discussed below, both FBAR and the individual reporting requirements under FATCA come with a heavy price for non-compliance. Because of the potential consequences for failure to file FBAR returns, prior to the expiry of OVDI in September 2011 tax preparers and advisers were inundated with questions and concerns, and overwhelmed with the preparation of the requisite documentation on behalf of clients who wished to take advantage of the partial amnesty.[10]

The prevailing climate of fear and uncertainty among US taxpayers in Canada was allayed to some extent by an article in the *Globe and Mail* on December 2, 2011.[11] The article reported that the IRS had agreed to tone down its aggressive stance on FBAR in light of the heavy volume of complaints received by the US ambassador to Canada.

The clarification anticipated by the *Globe and Mail* article was issued on December 7, 2011, by way of an IRS fact sheet.[12] The position set out in the fact sheet is simply that for non-resident US citizens and dual citizens who have failed to file their FBARs, any applicable penalties will be waived provided that the individual can establish that the failure to file was due to a "reasonable cause." All unfiled FBARs for the last six tax years need to be filed, together with a statement of explanation as to the reason for the delinquency, in order to attain compliant status.

Interestingly, the fact sheet does not contain any information that could be construed as "the big break from Uncle Sam" heralded in the *Globe and Mail* piece.[13] Rather, it merely reaffirms that FBAR filings are still mandatory and that penalties will continue to apply. The fact sheet is silent on the issue of OVDI refunds for penalties paid under that initiative, a concern that the *Globe* article expected to be addressed in the IRS's response. It appears that the only comfort to be had from the fact sheet lies in the waiver of penalties for failure to file past FBAR returns if "reasonable cause" can be shown.

The fact sheet makes only the following reference to FATCA individual filings:

> 7. New reporting requirements for foreign financial assets
>
> A new law requires U.S. taxpayers who have an interest in certain specified foreign financial assets with an aggregate value exceeding $50,000 to report those assets to the IRS. This reporting will be required beginning in 2012. Taxpayers who are required to

9 Foreign Account Tax Compliance Act, subtitle A of title V of the Hiring Incentives To Restore Employment Act of 2010, Pub. L. no. 111-147, enacted on March 18, 2010.

10 See, for example, Golombek, supra note 1.

11 Barrie McKenna, "IRS Easing Up on Tax Rules for U.S. Residents in Canada," *Globe and Mail*, December 2, 2011.

12 Internal Revenue Service, "Information for U.S. Citizens or Dual Citizens Residing Outside the U.S.," *Fact Sheet* FS-2011-13, December 7, 2011.

13 Supra note 11.

report must submit Form 8938 with their tax return. See Notice 2011-55 for additional information about this reporting requirement under IRC section 6038D.

The defence of "reasonable cause" is also available in respect of the FATCA individual reporting requirements.[14]

On January 9, 2012, the IRS announced the implementation of yet another OVDI program.[15] The IRS is expected to release further information about the 2012 OVDI in the near future.[16]

While we wait for more information from the IRS, US citizens and green-card holders living outside the United States still face uncertainty, as do legal and accounting practitioners who are attempting to advise their clients.

This article examines the origins of the FBAR and FATCA individual reporting requirements and the obligations imposed under them. The main goal is to determine whether civil penalties for failing to file under either regime can be enforced in Canada. The article does not address matters of enforcement in other foreign jurisdictions or within the United States.[17]

The discussion that follows considers only tangentially issues related to any actual tax liability triggered from information provided on FBAR or FATCA returns. In this regard, it is important to bear in mind that the FBAR and FATCA individual reporting requirements do not in and of themselves create tax liability—they are merely information returns. The motivation in the preparation of this article is to attempt to allay the fears of those individuals resident in Canada who are not in any way attempting to subvert the US tax system but are essentially "innocent bystanders"—victims, for lack of a better word, of their own US citizenship.

THE FBAR REPORTING REQUIREMENTS

As indicated above, FBAR is not part of the IRC but rather an offshoot of the US bank secrecy legislation enacted in 1970 (the BSA). Congress enacted the BSA as a means of imposing certain record-keeping and reporting requirements on financial institutions to assist federal agencies in various criminal, tax, or regulatory proceedings.[18]

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14 See IRC section 6038D(g), set out in appendix 3 to this article.

15 Marla Waiss, "Third US Offshore VDP" (2012) 20:2 *Canadian Tax Highlights* 1-2.

16 See Internal Revenue Service, "IRS Offshore Programs Produce $4.4 Billion To Date for Nation's Taxpayers; Offshore Voluntary Disclosure Program Reopens," *News Release* IR-2012-5, January 9, 2012.

17 For example, liens or other means of enforcing payment on assets situated within the United States.

18 Robert S. Pasley, "Recent Developments in Bank Secrecy Act Enforcement" (2005) 9 *North Carolina Banking Institute Journal* 61-102, at 61. The current statement of purpose is set out in 31 USC section 5311, which states: "It is the purpose of this subchapter (except section 5315) to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism."

Titles I and II of the BSA dealt with record keeping and reporting respectively. Implementing regulations were soon passed by the secretary of the Treasury under the authority of Congress. The regulations required banks to make copies of

> virtually every aspect of a customer's transactions, including many types of checks, and to maintain records of currency transactions of more than $10,000 involving accounts or persons outside the United States and to maintain records of extensions of credit (except those secured by real property) in excess of $5,000.[19]

The regulations also required financial institutions to report certain domestic and foreign transactions to the IRS.[20]

The foreign reporting requirements of the BSA were implemented by regulation and came to be formally known as the Report of Foreign Bank and Financial Accounts and colloquially as FBAR.

The legislative authority for the imposition of FBAR is now found in 31 USC section 5314,[21] which provides as follows:

> (a) Considering the need to avoid impeding or controlling the export or import of monetary instruments and the need to avoid burdening unreasonably a person making a transaction with a foreign financial agency, the Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency. The records and reports shall contain the following information in the way and to the extent the Secretary prescribes:
>
> (1) the identity and address of participants in a transaction or relationship.
>
> (2) the legal capacity in which a participant is acting.
>
> (3) the identity of real parties in interest.
>
> (4) a description of the transaction.
>
> (b) The Secretary may prescribe—
>
> (1) a reasonable classification of persons subject to or exempt from a requirement under this section or a regulation under this section;
>
> (2) a foreign country to which a requirement or a regulation under this section applies if the Secretary decides applying the requirement or regulation to all foreign countries is unnecessary or undesirable;
>
> (3) the magnitude of transactions subject to a requirement or a regulation under this section;
>
> (4) the kind of transaction subject to or exempt from a requirement or a regulation under this section; and

19 James A. Peden Jr., "A Dilemma for Banks: Disclosure of Customer Records in Legal Proceedings" (1983) 4:1 *Mississippi College Law Review* 1-46, at 22.

20 Ibid.

21 USC title 31, "Money and Finance"; subtitle IV, "Money"; chapter 53, "Monetary Transactions"; subchapter II, "Records and Reports on Monetary Instruments Transactions"; section 5314, "Records and Reports on Foreign Financial Agency Transactions."

> (5) other matters the Secretary considers necessary to carry out this section or a regulation under this section.
>
> (c) A person shall be required to disclose a record required to be kept under this section or under a regulation under this section only as required by law.

The regulation implementing the secretary's power[22] is reproduced in appendix 1 to this article.

FBAR is now physically embodied as form TD F 90-22.1.[23] Although on the face of the legislation, the administration and enforcement of the BSA and its regulations lies with the Treasury department, that function was delegated to the Financial Crimes Enforcement Network (FinCEN), which in turn delegated its authority to administer the BSA to the IRS.[24]

Form TD F 90-22.1 clearly states that the form is not to be filed with a person's federal tax return; instead, it is to be filed with the US Department of the Treasury. However, part III of schedule B of form 1040 (the US individual income tax return) instructs the filer to complete the FBAR form if the filer during the tax year had "a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country" and does not fall within the exceptions set out on the form. Thus, there is a tie-in between the federal tax return and the FBAR reporting requirement.

The penalties for failure to comply with the FBAR regime are severe; indeed, they have been described as "draconian."[25] The civil penalties are set out, in part, in 31 CFR section 1010.820(g), which provides:

> (g) For any willful violation committed after October 27, 1986, of any requirement of §1010.350, §1010.360 or §1010.420, the Secretary may assess upon any person, a civil penalty: . . .
>
> (2) In the case of a violation of §1010.350 or §1010.420 involving a failure to report the existence of an account or any identifying information required to be provided with respect to such account, a civil penalty not to exceed the greater of

22 31 CFR section 1010.350, "Reports of Foreign Financial Accounts."

23 Supra note 6.

24 See Lewis J. Saret, Charles M. Bruce, and Michael C. Durney, "The FBAR: A Primer" (2009) 34:5 *Tax Management Estates, Gifts and Trusts Journal* 217-27. See also 31 CFR section 1010.810(g), which states, "The authority to enforce the provisions of 31 U.S.C. 5314 and §§1010.350 and 1010.420 of this chapter has been redelegated from FinCEN to the Commissioner of Internal Revenue by means of a Memorandum of Agreement between FinCEN and IRS. Such authority includes, with respect to 31 U.S.C. 5314 and 1010.350 and 1010.420 of this chapter, the authority to: assess and collect civil penalties under 31 U.S.C. 5321 and 31 CFR 1010.820; investigate possible civil violations of these provisions (in addition to the authority already provided at paragraph (c)(2)) of this section); employ the summons power of subpart I of this part 1010; issue administrative rulings under subpart G of this part 1010; and take any other action reasonably necessary for the enforcement of these and related provisions, including pursuit of injunctions."

25 See Saret et al., supra note 24, at 219.

the amount (not to exceed $100,000) equal to the balance in the account at the time of the violation, or $25,000.

As to "non-wilful" violations, civil penalties are capped at $10,000.[26] In the case of wilful violations, the penalty is, at least to some degree, tied to the amount of the unreported asset.

THE FATCA REPORTING REQUIREMENTS

Although FBAR has been around for more than 40 years, FATCA was enacted just two years ago as part of the Hiring Incentives To Restore Employment Act (HIRE).[27] Part I of subtitle A, title V of HIRE is entitled "Foreign Account Tax Compliance" and inserts a number of provisions directly into the body of the IRC.

While much has been written in the popular press regarding the impending intrusion into the Canadian banking system by FATCA, as noted above FATCA also embodies a foreign asset reporting requirement not dissimilar to that established under the BSA (that is, FBAR). When examining FATCA, these two components are best dealt with separately.

Reporting Requirements for Foreign Financial Institutions

The new reporting requirements for foreign financial institutions (FFIs) are set out in IRC sections 1471 through 1474. On February 8, 2012, the IRS issued REG-121647-10, an extensive set of proposed new regulations to 26 CFR part 1.[28] The basic structure of this scheme is to provide for a withholding tax of 30 percent applicable to

> (i) any payment of interest (including any original issue discount), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, if such payment is from sources within the United States, and
>
> (ii) any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States.[29]

FATCA withholdings will be levied only on any FFI that is not participating in the reporting program. For the purposes of FATCA, IRC sections 1471(d)(4) and (5) define an FFI as any foreign entity that

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26 31 USC section 5321(a)(5)(B)(i).

27 Supra note 9. For commentary, see James Hamilton, "Jobs Bill Places Offshore Financial Firms Under Reporting and Tax Regime," *CCH Briefing Special Report*, March 2010 (http://business.cch.com/briefings/jobsbill.pdf).

28 Internal Revenue Service, "Treasury, IRS Issue Proposed Regulations for FATCA Implementation," *News Release* IR-2012-15, February 8, 2012. The proposed regulations (REG-121647-10) and accompanying explanation take up almost 400 pages. (The document is available at www.irs.gov/pub/newsroom/reg-121647-10.pdf.) The IRS invited the submission of written or electronic comments by April 30, 2012.

29 IRC section 1473, definition of "withholdable payment."

(A) accepts deposits in the ordinary course of a banking or similar business,

(B) as a substantial portion of its business, holds financial assets for the account of others, or

(C) is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities (as defined in section 475(c)(2) without regard to the last sentence thereof), partnership interests, commodities (as defined in section 475(e)(2)), or any interest (including a futures or forward contract or option) in such securities, partnership interests, or commodities.

This expansive definition would thus take in all chartered Canadian banks, stockbrokers, and virtually any entity engaged in the financial sector in Canada—"everybody from financial advisors to pension funds."[30]

In order to escape the withholding requirement, an FFI must enter into an agreement with the secretary of the Treasury under which the FFI covenants to collect and provide to the IRS detailed information about its clients and the nature of their holdings. Once it fulfills this obligation, the FFI attains the status of a participating foreign financial institution (PFFI) and is exempt from withholding.

It should be noted that the withholding requirements applicable to non-PFFIs do not supplant the usual withholding rates set out in the IRC or in any applicable tax treaty for non-resident aliens of the United States.[31]

30 "Scratched by the FATCA," *The Economist*, November 26, 2011, 86-87, at 86.

31 In accordance with IRC section 1474(b)(1), so long as the information required under the FATCA rules is provided to the IRS, any excess withholding will be refundable to the beneficial owner to the extent provided for in the non-resident withholding tax rules set out in sections 1441 through 1446. In this regard, Treas. reg. section 1.1441-6 provides that withholding imposed under any of IRC sections 1441 through 1443 is eligible for reduction under the terms of an income tax treaty "only to the extent that such payment is treated as derived by a resident of an applicable treaty jurisdiction, such resident is a beneficial owner, and all other requirements for benefits under the treaty are satisfied." Withholding amounts from payments beneficially owned by a US taxpayer may be credited against the taxpayer's regular income tax. See Peter H. Blessing and Michael J. Miller, "FATCA's Far-Reaching Effect," in *Report of Proceedings of the Sixty-First Tax Conference*, 2009 Conference Report (Toronto: Canadian Tax Foundation, 2010), 17:1-29.

Thus, considering a situation where a non-US taxpayer resident in Canada earns interest income on a certain US-based security, by virtue of the interplay between IRC section 1474(b)(1), Treas. reg. section 1.1441-6, and article XI of the Canada-US tax treaty (the Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital, signed at Washington, DC on September 26, 1980, as amended by the protocols signed on June 14, 1983, March 28, 1984, March 17, 1995, July 29, 1997, and September 21, 2007, herein referred to as "the Canada-US tax treaty" or "the treaty"), the 30 percent FATCA withholding rate that might otherwise apply would give way to a 0 percent withholding rate so long as all of paragraphs 3 through 7 of article XI applied and the income earned would fall within the definition of "interest" for the purposes of paragraph 2 of article XI. Of course, if the non-resident alien investor has invested with a PFFI, there will have been no FATCA withholding in the first place.

In respect of private bank accounts held with a PFFI, IRC section 1471 sets out the following reporting requirements:

> (c) INFORMATION REQUIRED TO BE REPORTED ON UNITED STATES ACCOUNTS.—
>
> (1) IN GENERAL.—The agreement described in subsection (b) shall require the foreign financial institution to report the following with respect to each United States account maintained by such institution:
>
> (A) The name, address, and TIN [taxpayer identifying number] of each account holder which is a specified United States person and, in the case of any account holder which is a United States owned foreign entity, the name, address, and TIN of each substantial United States owner of such entity.
>
> (B) The account number.
>
> (C) The account balance or value (determined at such time and in such manner as the Secretary may provide).
>
> (D) Except to the extent provided by the Secretary, the gross receipts and gross withdrawals or payments from the account (determined for such period and in such manner as the Secretary may provide).

To illustrate the magnitude of the reporting burden imposed by FATCA, appendix 2 reproduces details regarding the documentation to be provided by FFIs in respect of certain accounts held by US taxpayers.

Clearly, compliance with the rules summarized above (which represent only a small part of the requirements issued to date) constitutes a massive undertaking. Even in the United States, some commentators have condemned FATCA on the basis that it not only impinges on the sovereignty of foreign nations, but also will encourage many investors not to "buy American" owing to burdens of compliance.[32]

Sovereignty and the compliance burden are not the only issues. FATCA compliance also raises serious issues regarding the privacy of personal information. From a Canadian perspective, the federal Personal Information Protection and Electronic Documents Act[33] (PIPEDA), which applies to the collection and use of personal information by "a federal work, undertaking or business" (including banks),[34] permits such collection and use with the consent of the person to whom the information pertains. In those inevitable cases where consent is not explicitly provided, the interplay between PIPEDA and FATCA compliance efforts raises complex legal and policy issues that are far beyond the scope of this article.

Not surprisingly, there have been significant lobbying efforts to either eliminate or ameliorate the enormous impact that FATCA will have on the banking and investment industries. In a statement made in Congress regarding a proposed new bill (the "Stop Tax Haven Abuse Act"), Senator Carl Levin (Mich.) observed:

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32 See, for example, Scott D. Michel and H. David Rosenbloom, "FATCA and Foreign Bank Accounts: Has the U.S. Overreached?" (2011) 62:9 *Tax Notes International* 709-13.

33 SC 2000, c. 5, as amended.

34 PIPEDA section 2(1)(g).

> Last year also saw enactment of the Baucus-Rangel Foreign Account Tax Compliance Act or FATCA, which is a tough new law designed to flush out hidden offshore bank accounts. Foreign banks are currently engaged in a massive lobbying effort to weaken its disclosure requirements, but U.S. banks have had it with foreign banks using secrecy to attract U.S. clients and want those banks to have to meet the same disclosure requirements U.S. banks do. The Administration is so far resisting calls to water down the provisions.[35]

Assuming that the US government's resolve as regards the maintenance of the strictures and requirements of FATCA is as firm as Senator Levin seems to suggest, we may well be headed toward a confrontation between the United States and Canada on this issue. Indeed, Canadian Finance Minister Jim Flaherty has commented that the FFI reporting requirements would "turn Canadian banks into extensions of the IRS and would raise significant privacy concerns for Canadians."[36]

In light of the foregoing, it is interesting to note Canada's rather conspicuous absence from the recently announced joint statement by the United States and five other countries (France, Germany, Italy, Spain, and the United Kingdom) regarding efforts to improve international tax compliance and, in particular, the implementation of FATCA.[37] The statement makes bilateral, at least as regards the participating nations, that which had been unilateral. Specifically, the joint statement explicitly recognizes the practical legal and policy impediments faced by foreign nations in terms of FATCA compliance and provides that, as consideration for the cooperation of the "FATCA partners"[38] in taking all required steps to compel their FFIs to comply with FATCA, the United States would agree to forgo certain of the formalities contained in the FATCA regulations (for example, the requirement for each affected FFI to enter into an agreement with, and furnish information directly to, the US Treasury). The statement also demonstrates an apparent willingness on the part of the United States to reciprocate in the collection and exchange of information on accounts held in US financial institutions by residents of the FATCA partners.

As a "non-FATCA partner," Canada remains subject to the FATCA regime as amended by the proposed new regulations. Reporting on income will be required commencing in 2016 with respect to the 2015 tax year, and withholding obligations

35 *Congressional Record*, July 12, 2011, at S4519.

36 Barbara Schecter, "Back Off Our Taxpayers, Flaherty Tells U.S.," *National Post*, September 17, 2011.

37 "Joint Statement from the United States, France, Germany, Italy, Spain and the United Kingdom Regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA," released February 9, 2012 (www.treasury.gov/press-center/press-releases/Documents/020712%20Treasury%20IRS%20FATCA%20Joint%20Statement.pdf).

38 "FATCA partners" is the term used in the text of the joint statement to describe the foreign countries that have signed off on the principles espoused in the document. The choice of the term may well have been designed to send a message to non-signatories—that their absence could perhaps be viewed as signalling an intention not to cooperate.

that had been slated, under IRS Notice 2011-53,[39] to begin at some point after January 1, 2015, are, at least for the time being, postponed until 2017.[40] In the meantime, since the regulations are still only "proposed," further adjustments may well be made to the new rules.

Reporting Requirements for Individuals

As noted above, FBAR now has a close cousin. With the enactment of FATCA came additional reporting requirements for US taxpayers. This provision is now set out in IRC section 6038D, which is reproduced in appendix 3.

The much-anticipated form 8938 "Statement of Foreign Financial Assets" was finally unveiled on December 14, 2011, along with a set of temporary regulations enacted with a view to providing guidance on the individual reporting requirements under FATCA.[41] Form 8938 is to be attached to a filer's tax return.

As is the case with FBAR, the FATCA reporting requirements for individuals apply to both resident and non-resident US taxpayers, including US citizens and green-card holders permanently residing abroad. It bears repeating that, in the case of green-card holders, the obligation subsists for as long as the green card has not been rescinded or administratively or judicially determined to have been abandoned, regardless of the fact that the green card may no longer be recognized as valid according to US immigration laws.[42]

Civil Penalties for Non-Compliance with FATCA Individual Reporting Requirements

As stipulated in IRC section 6038D, penalties for failure to disclose the requisite information will result in a fine of $10,000 for each taxation year. If a notice is sent to a US taxpayer of his or her failure to disclose, the taxpayer has 90 days to comply or risk further penalties of $10,000 per month that the non-compliance continues (to a maximum of $50,000).

INDIVIDUAL AND INSTITUTIONAL REPORTING REQUIREMENTS UNDER THE INCOME TAX ACT

Not surprisingly, Canada also imposes foreign reporting requirements on its taxpayers. These are set out in sections 233.2 through 233.6 of the Income Tax Act

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39 Notice 2011-53, 2011-32 IRB 124.

40 Mark A. Luscombe, "Proposed FATCA Regulations—Trying To Make It Work" (2012) 90:4 *Taxes: The Tax Magazine* 3-5, at 4.

41 See Mary Burke Baker, "The Tin Can Buried in the Backyard: How Revised FBAR and New FATCA Information Reporting Rules May Stage a Comeback" (2012) 25:1 *Benefits Law Journal* 5-23.

42 Green-card holders are termed "lawful permanent residents" of the United States for the purposes of US federal income tax. See supra note 3, and *2012 U.S. Master Tax Guide* (Chicago: CCH, 2011), at paragraph 2409, "Resident Aliens."

(ITA).[43] For example, section 233.3 requires the filing of T1135 forms[44] in respect of certain foreign property owned by a "specified Canadian entity" if the cost amount to the entity of such property is in excess of $100,000. As with FBAR and FATCA, failure to comply with these individual reporting obligations will result in significant penalties.[45]

The ITA also imposes certain reporting requirements for financial institutions; for example, in the case of investment income, the institution is obliged to submit to the Canada Revenue Agency (CRA) "an information return in prescribed form in respect of the portion of such payment [of investment income] for which an information return has not previously been made."[46] In this case, the prescribed form is the T5 "Return of Investment Income." The Canadian reporting obligation is thus much narrower than the FFI requirements under FATCA.

This is an important distinction. While the information return provisions set out in the regulations to the ITA require payers (such as employers, financial institutions, and insurance companies) to furnish information returns to the CRA identifying the taxpayer along with the amount of any payment made (whether it be, for example, employment income,[47] interest income,[48] or accrued bond interest[49]), there is no requirement to provide information regarding the nature and extent of assets held by an institution or other payer on behalf of a taxpayer. In other words, the Canadian system only requires the reporting of payments relevant to the calculation of the recipient's tax liability.[50] This is not the case with the FATCA reporting requirements for FFIs, which require details on amounts on deposit and transactions relating to assets.[51]

The importance of this distinction will be developed further below.[52]

ENFORCEMENT MECHANISMS

As stated at the outset, the primary goal of this article is to determine whether the IRS can pursue those individuals resident in Canada who fall within the scope of FBAR and the reporting requirements of FATCA and do not comply with the respective

43 RSC 1985, c. 1 (5th Supp.), as amended.

44 Canada Revenue Agency form T1135, "Foreign Income Verification Statement."

45 See for example, ITA subsections 162(10) and (10.1), and 163(2.4).

46 See ITA regulation 201(1).

47 ITA regulation 200(1).

48 ITA regulation 201(1)(b).

49 ITA regulation 211(1).

50 This makes sense. It is difficult to see the relevance to tax liability of, for example, the tax-paid principal amount in a bank account.

51 See IRC sections 1471(c)(1)(C) and (D), reproduced above (following the reference to note 31).

52 See, in the context of enforceability of the FACTA provisions in Canadian courts, the discussion under the heading "Constitutional Law Considerations."

rules. The first logical step in this analysis is to examine the jurisdiction of the courts to entertain such a claim.

There are two potential forums for enforcement of FBAR and FATCA in Canada. The first would involve applications or suits brought by the United States in Canadian courts under common-law principles of international law; the second would see application for enforcement under the administrative assistance-in-collection provisions of the Canada-US tax treaty.[53] The likely outcome in each of these circumstances, based on the current law and jurisprudence, is discussed in the sections that follow.

Are FBAR and FATCA Penalties Enforceable in Canadian Courts Under the Common Law?

Insofar as international law is concerned, it is vital to recognize that judicial attitudes have shifted over the past quarter-century or so toward increased recognition of the judgments of foreign courts. The ever-expanding "global economy" and the emergence of e-commerce have often been cited as major factors behind this trend. Moreover, the increase in large-scale cross-border commerce has begotten a concomitant increase in the mobility of individuals and their assets and the proliferation of jurisdictional issues.

As the economies of nations continue to intertwine, the laws of those nations have by necessity been forced to adapt to the new world order. Accordingly, common-law principles born in a bygone era are often viewed as antiquated, outmoded, and anachronistic. The judiciary and the legislatures, as servants of society, have struggled to keep up with these changes and to develop laws that are more in tune with the economic and political realities that shape the issues that affect their citizens and the litigation that is conducted in their courtrooms.

One of the cornerstones of the judicial response to these political and economic realities is the expansion of the application of the principle of comity.

Judicial Comity

In a 1990 decision, *Morguard Investments Ltd. v. De Savoye*,[54] the Supreme Court of Canada signalled a move away from the old common-law rules regarding the enforcement of foreign judgments.

Writing for a unanimous court, La Forest J opined that the common-law rules relating to private international law were long overdue for a critical re-examination. These rules, he stated, were developed largely in the United Kingdom in a judicial climate that favoured the principle of territoriality and, accordingly, were outdated. His analysis began with the premise that modern states "cannot live in splendid isolation," foreshadowing the shift that was to follow. He wrote:

53 Canada-US tax treaty, supra note 31.

54 [1990] 3 SCR 1077.

> The world has changed since the above rules were developed in 19th century England. Modern means of travel and communications have made many of these 19th century concerns appear parochial. The business community operates in a world economy and we correctly speak of a "world community" even in the face of decentralized political and legal power. Accommodating the flow of wealth, skills and people across state lines has now become imperative. Under these circumstances, our approach to the recognition and enforcement of foreign judgments would appear ripe for reappraisal. Certainly, other countries, notably the United States and members of the European Economic Community, have adopted more generous rules for the recognition and enforcement of foreign judgments, to the general advantage of litigants.
>
> However that may be, there is really no comparison between the interprovincial relationships of today and those obtaining between foreign countries in the 19th century. Indeed, in my view there never was and the courts made a serious error in transposing the rules developed for the enforcement of foreign judgments to the enforcement of judgments from sister provinces. The considerations underlying the rules of comity apply with much greater force between the units of a federal state, and I do not think it much matters whether one calls these rules of comity or simply relies directly on the reasons of justice, necessity and convenience to which I have already adverted. Whatever nomenclature is used, our courts have not hesitated to cooperate with courts of other provinces where necessary to meet the ends of justice.[55]

Although *Morguard* dealt with the enforceability of judgments of one province within another, the "real and substantial connection test" formulated in *Morguard*[56] has been refined since the decision was released, and with the decision of the Supreme Court in *Beals v. Saldanha*,[57] any remaining uncertainty as to whether its principles should apply to foreign judgments[58] has been put to rest, at least in the context of private international law.[59]

The core of any argument regarding the enforceability of foreign (or extraprovincial) judgments is necessarily based upon the principle of judicial comity, which the court in *Morguard* defined as

> the deference and respect due by other states to the actions of a state legitimately taken within its territory. . . .
>
> the recognition which one nation allows within its territory to the legislative, executive and judicial acts of another nation, having due regard both to international duty

55 Ibid., at 1096.

56 Ibid., at 1108.

57 2003 SCC 72.

58 That is, non-Canadian judgments. See, for example, *Spar Aerospace Ltd. v. American Mobile Satellite Corp.*, 2002 SCC 78, where LeBel J expressed, in obiter, some reluctance to extend the *Morguard* principle to foreign disputes.

59 But see *Pro Swing Inc. v. Elta Golf Inc.*, 2006 SCC 52, where the majority stated that the case for the enforcement of non-monetary foreign judgments is compelling, but that the instant case was not the appropriate one to formalize a change from the common-law rule that in order to be recognizable and enforceable, a foreign judgment must be for a definite sum of money.

> and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws.[60]

The Supreme Court in *Beals* opined that the old common-law principles were "outmoded"[61] and that they should be "amended by rules intended to facilitate the flow of wealth, skills and people across boundaries, particularly boundaries of a federal state."[62] Likewise, the Supreme Court in *Tolofson v. Jensen* stated:

> The underlying postulate of public international law is that generally each state has jurisdiction to make and apply law within its territorial limit. Absent a breach of some overriding norm, other states as a matter of "comity" will ordinarily respect such actions and are hesitant to interfere with what another state chooses to do within those limits. Moreover, to accommodate the movement of people, wealth and skills across state lines, a byproduct of modern civilization, they will in great measure recognize the determination of legal issues in other states. And to promote the same values, they will open their national forums for the resolution of specific legal disputes arising in other jurisdictions consistent with the interests and internal values of the forum state. These are the realities that must be reflected and accommodated in private international law. . . .
>
> As *Morguard* and *Hunt* also indicate, the courts in the various states will, in certain circumstances, exercise jurisdiction over matters that may have originated in other states. And that will be so as well where a particular transaction may not be limited to a single jurisdiction. Consequently, individuals need not in enforcing a legal right be tied to the courts of the jurisdiction where the right arose, but may choose one to meet their convenience. This fosters mobility and a world economy.[63]

Ultimately, the court in *Beals* concluded that the real and substantial connection test first set out in *Morguard* should apply to the recognition and enforcement of foreign judgments as well. This conclusion was based upon principles of judicial comity.[64]

The Real and Substantial Connection Test

In *Beals*, Major J asserted that the real and substantial connection test requires that "a significant connection exist between the cause of action and the foreign court."[65] Perhaps more importantly for the purposes of this article, he also stated:

> Furthermore, a defendant can reasonably be brought within the embrace of a foreign jurisdiction's law where he or she has participated in something of significance or was

60 Per La Forest J in *Morguard*, supra note 54, at 1095-96, quoting *Hilton v. Guyot*, 159 US 113, at 163-64 (1895).

61 Per Major J in *Beals*, supra note 57, at paragraph 20.

62 Ibid., at paragraph 21.

63 [1994] 3 SCR 1022, at paragraphs 37 and 40.

64 Per Major J in *Beals*, supra note 57, at paragraph 29.

65 Ibid., at paragraph 32.

> actively involved in that foreign jurisdiction. A fleeting or relatively unimportant connection will not be enough to give a foreign court jurisdiction. The connection to the foreign jurisdiction must be a substantial one.[66]

In the context of the enforcement of US tax judgments in Canada, the application of the real and substantial connection test could become an interesting legal and intellectual exercise, especially where the judgment is against a US citizen who has never resided in the United States at all, or perhaps at least not since childhood.

A logical question to ask in this context is whether the mere fact of citizenship is enough to satisfy the real and substantial connection test in light of the fact that in most cases, the status of citizenship is something that *happens* to an individual instead of something that arises from a choice. In other words, in the US context, even where a child is not born in the United States, citizenship can, in certain circumstances, be thrust upon him or her by virtue of the situation surrounding his or her birth, or the citizenship and/or immigration status of his or her parents, and there is no element of free choice to accept or decline it. By contrast, a child born in Canada who moved to the United States or some other country would not be subject to Canadian tax, and the issue of a real and substantial connection would never even arise for such an individual.

Since all US citizens are required to comply with US tax laws, there could well be cases in which a tax judgment against a non-resident is enforced in a US court—an outcome that might be viewed by a reasonable person as unjust if the defendant had never set foot in the United States and therefore had never derived any benefit from the fact of his or her citizenship. In such circumstances, a reasonable person might well regard the defendant's connection to the United States as "fleeting or relatively unimportant" (to use the language of Major J in *Beals*). However, for present purposes, I will not delve into an analysis of the rightness or wrongness of taxing on the basis of citizenship alone and will assume that the real and substantial connection is satisfied in a US income tax claim by mere citizenship, whatever the circumstances behind that status may be.

Defences

Not surprisingly, when viewing the issue of the potential enforceability of a foreign judgment in Canada, the Supreme Court has identified the presence of procedural safeguards as one of the most significant criteria for acceding to that judgment, such that our notion of fairness and natural justice would not be offended by enforcement of the foreign order. In this regard, there are at least three defences that a defendant may plead in order to avoid the application of a foreign order: natural justice, public

66 Ibid.

policy, and fraud.[67] Enforcing courts are not interested in the procedural or substantive nature of a foreign law unless one of these three elements is violated.[68]

In *Beals*, Major J pointed out that when procedural issues arise, the court

> has to consider whether those defences, when applied internationally, are able to strike the balance required by comity, the balance between order and fairness as well as the real and substantial connection, in respect of enforcing default judgments obtained in foreign courts.[69]

He did, however, point out that the three recognized defences must be applied narrowly, and that further types of defence may be carved out in the future.[70]

The Fraud Defence

The basic premise of the fraud defence is that "neither foreign nor domestic judgments will be enforced if obtained by fraud."[71] For obvious reasons, a challenge on this ground is not likely to arise in relations between US and Canadian courts, and for present purposes will be ignored.

The Natural Justice Defence

As stated in *Beals*, the natural justice defence imposes a reverse onus on the defendant to prove on a balance of probabilities that the "foreign proceedings were contrary to Canadian notions of fundamental justice."[72] In other words, the defendant must establish that a fair process was not granted to him or her. The term "fair process" in this context means one that "reasonably guarantees basic procedural safeguards such as judicial independence and fair ethical rules governing the participants in the judicial system."[73]

Again, it is assumed here that any court proceedings in the United States would meet this requirement, since the fifth amendment to the US constitution guarantees no deprivation of property without due process.

The Public Policy Defence

The public policy defence is open to a defendant who can prove that the enforcement of the foreign judgment is contrary to the "Canadian concept of justice."[74] Thus, if

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67 Ibid., at paragraphs 35 and 40, where Major J notes that these original three defences were developed prior to *Morguard*.

68 *Pro Swing Inc.*, supra note 59, at paragraph 12.

69 *Beals*, supra note 57, at paragraph 40.

70 Ibid., at paragraphs 41-42.

71 Ibid., at paragraph 43.

72 Ibid., at paragraph 59.

73 Ibid., at paragraph 62.

74 Ibid., at paragraph 71.

the judgment is obtained pursuant to a law that is itself contrary to the "fundamental morality of the Canadian legal system" (or can be considered to be "repugnant" to the Canadian system of justice), then the judgment should not be enforced.[75] The court in *Beals* emphasized that this is not a defence that will be used lightly.[76]

In general, where the defence is made out, the courts will apply the lex fori ("law of the forum").[77] Evidence of public policy can be gleaned from constitutional and local laws. The fact that the lex fori differs on the same point as the foreign law is not in and of itself sufficient ground to deny recognition of the foreign law.[78] As stated by Carthy JA in *Boardwalk Regency Corp. v. Maalouf*,

> [t]he common ground of all expressed reasons for imposing the doctrine of public policy is essential morality. This must be more than the morality of some persons and must run through the fabric of society to the extent that it is not consonant with our system of justice and general moral outlook to countenance the conduct, no matter how legal it may have been where it occurred.[79]

In *Boardwalk Regency Corp.*, the respondent was a resident of Ontario who had amassed a significant gambling debt at the appellant's casino in New Jersey. The respondent argued that to enforce the foreign judgment on the debt would be, in effect, to condone the practice of lending money for the purposes of encouraging gambling. The respondent cited the provisions of the now-repealed Ontario Gaming Act as evidence that it was the public policy of Ontario that the lending of money to finance gambling should not be tolerated. The Ontario Court of Appeal held that the provisions of the Gaming Act could not, in the circumstances, be said to represent the public policy of the province and that the contract, not having been "tainted" by immorality, should be enforced.

Likewise, in *Minkler & Kirschbaum v. Sheppard*,[80] the BC Supreme Court held that an Arizona law that had the effect of making a non-contracting spouse jointly liable for a breach of contract committed by her spouse was not contrary to our conceptions of essential justice and morality, and therefore the Arizona judgment should be enforced in British Columbia.

Since the inquiry is one into "essential morality," it is not surprising that Canadian courts have been reluctant to deal with the public policy defence in the context of the enforcement of a foreign law.[81] It is submitted that enforcement efforts by the

75 Ibid., at paragraph 72.

76 Ibid., at paragraph 75.

77 Jean-Gabriel Castel and Janet Walker, *Canadian Conflict of Laws*, 6th ed., vol. 1 (Markham, ON: LexisNexis Canada, 2005), at paragraph 8.6.

78 Ibid.

79 (1992), 88 DLR (4th) 612, at 622 (Ont. CA).

80 (1991), 60 BCLR (2d) 360 (SC).

81 Castel and Walker, supra note 77, at section 8.6.

United States of FATCA or FBAR fines and/or penalties would not easily be frustrated by the public policy defence for the simple reason that it is difficult to conceive how these laws, even if unconstitutional from a Canadian standpoint, could be considered to be in some way contrary to the Canadian sense of "essential morality."[82]

Bars to an Action

It is imperative to understand that the decision of the Supreme Court in *Beals*[83] dealt with *private* international law. Nonetheless, the discussion and the enunciated principles dealing with comity in that case are important in gauging the potential for application of the comity doctrine to public laws, including taxing statutes. Before a claim can succeed inside a Canadian courtroom, there are at least two further potential hurdles that must be overcome—reliance on the revenue rule and the so-called penal rule. These, along with issues relating to constitutional law, are discussed below.

The Revenue Rule

It is a long-settled rule, deeply entrenched among the courts of most western democracies, that the revenue laws of other countries should not be enforced within domestic courts.[84] This doctrine has been referred to as "the revenue rule." Although the history of the rule's origins provides a fascinating account of the political mores prevalent prior to the industrial revolution, it is beyond the scope of this article to review that background.[85] Suffice it to say that a major rationale for the development and retention of the rule was to ensure the preservation of a nation's sovereignty. In the words of one commentator, "domestic recognition of foreign laws and judgments ceases at the point where enforcement of a foreign claim would allow a foreign government, directly or indirectly, to collect foreign taxes from the domestic tax base."[86]

Unfortunately, an unintended consequence of the revenue rule has been the creation of opportunities for various tax-avoidance schemes, since persons seeking to avoid the revenue laws of their native lands could be confident that those laws would not be enforced in foreign jurisdictions.[87] This result has been partly responsible for

82 See the discussion in the text below following note 109.

83 And, indeed, the cases that preceded it, such as *Morguard* and *Hunt v. T&N plc*, infra note 145.

84 David Bishop Debenham, "From the Revenue Rule to the Rule of the 'Revenuer': A Tale of Two Davids and Two Goliaths" (2008) 56:1 *Canadian Tax Journal* 1-66.

85 For a comprehensive treatment of the history of the rule, see Debenham, ibid. See also Will Rearden, "'A Delicate Inquiry': Foreign Policy Concerns Revive the Revenue Rule in the Second Circuit and Bar Foreign Governments from Suing Big Tobacco" (2006) 51:1 *St. Louis University Law Journal* 203-39; and Brenda Mallinak, "The Revenue Rule: A Common Law Doctrine for the Twenty-First Century" (2006) 16:1 *Duke Journal of Comparative and International Law* 79-124.

86 Debenham, supra note 84, at 11.

87 Ibid.

a movement among certain tax scholars who decry the continued existence of the rule and argue that principles of comity require it to be, at the very least, watered down.[88]

There are clearly compelling arguments for the removal of the strictures of the revenue rule. As stated by one commentator,

> [e]nforcing foreign tax claims has been acknowledged to benefit the notion of comity, support the notion of justice, and benefit each individual nation as a whole. It would obviously benefit the notion of international comity, as countries would be able to co-operate and show respect for the laws of one another. It would support the notion of justice, as tax evaders would be forced by their sheltering countries to pay their debt, and would not be allowed to shirk this obligation solely due to geographic location. Finally, it would benefit nations as a whole, as each person would pay his or her fair share of a national tax burden. For example, if the United States is unable to collect a hypothetical tax judgment from Canadian courts, the tax burden which is created by that lack of enforcement will either drain the United States' treasury, or, more likely, will be a burden to be shared by other United States taxpayers. Thus, a system in which each country enforces foreign tax claims will not only be fair, but will also benefit taxpayers in all countries. As Justice Joseph Story noted, cooperation in enforcement of tax claims is "an enlightened policy, founded upon national justice, as well as national interest."[89]

Since the 1963 decision of the Supreme Court of Canada in *United States of America v. Harden*[90] (discussed below), the leading Canadian case on the application of the revenue rule, Canadian courts have acknowledged the existence of these criticisms. In *Stringam v. Dubois*, decided some 30 years after *Harden*, the Alberta Court of Appeal stated:

> I have not overlooked the fact that the decision of the Supreme Court in *Harden* has been criticized as an older rule that is not responsive to modern circumstances. (See Castel, *Canadian Conflict of Laws*, 1st ed., p. 73, and McLeod, *The Conflict of Laws* (1983), pp. 209-13.) Nevertheless the rule remains the law of Canada and I am bound by it.[91]

In 2004, a leading Canadian commentator suggested:

> In theory, the common law revenue rule reflects the principle that a country has exclusive sovereignty over its tax policy. However, Lord Mansfield's rule has limited scope

88 See, for example, Jonathan M. Weiss, "Tax Claims in Transnational Insolvencies: A 'Revenue-Rule-Approach'" (2010) 30:1 *Virginia Tax Review* 261-325; Barbara A. Silver, "Modernizing the Revenue Rule: The Enforcement of Foreign Tax Judgments" (1992) 22:3 *Georgia Journal of International and Comparative Law* 609-33; and William J. Kovatch Jr., "Recognizing Foreign Tax Judgments: An Argument for the Revocation of the Revenue Rule" (1999) 22:2 *Houston Journal of International Law* 265-88.

89 Weiss, supra note 88, at 306.

90 Infra note 94.

91 (1992), 7 Alta. LR (3d) 120, at 125 (CA).

> in a world of increasing regulatory supervision and information exchange between countries on money laundering and terrorism financing.
>
> The traditional rule that a country will not enforce the revenue laws of another country and that no country is under an obligation to disclose financial information to foreign governments is very much on its way to extinction.[92]

This prediction has yet to be fulfilled. The revenue rule remains the law of the land, at least in the common-law sphere.[93]

As noted above, the leading authority in Canada is the decision of the Supreme Court in *Harden*.[94] In this case, the court was asked to enforce a US judgment in the amount of $602,919.10 on account of income tax arrears and interest. At the time of the hearing, the taxpayer, Harden, was a resident of British Columbia.

The taxpayer asserted that the court lacked jurisdiction to enforce the judgment. The trial judge had set aside a writ of summons issued by the appellant and all subsequent proceedings on the basis that "the action was an attempt to enforce the revenue laws of a foreign State."[95] The BC Court of Appeal upheld the trial judge's findings, and the United States brought an appeal to the Supreme Court.

Although the United States did not question the "well-established" rule "that a foreign State is precluded from suing in [Canada] for taxes due under the law of the foreign State,"[96] it argued that this rule did not apply to the enforcement of *judgments* on account of tax arrears. Cartwright J, writing on behalf of a unanimous court, relied upon the revenue rule in dismissing the appeal.

In reaching his conclusion, Cartwright J cited the decision of the House of Lords in *Government of India v. Taylor*,[97] in which Viscount Simonds followed the reasoning of Rowlatt J in *The King of the Hellenes v. Brostron* where he stated:

> It is perfectly elementary that a foreign government cannot come here—nor will the Courts of other countries allow our Government to go there—and sue a person found in that jurisdiction for taxes levied and which he is declared to be liable to by the country to which he belongs.[98]

Cartwright J then delved into the policy reasons for the creation of the rule. Referring again to *Government of India v. Taylor*, he cited the following passage from the judgment of Lord Keith of Avonholm:

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92 Vern Krishna, "Demise of the Revenue Rule in Tax Law," *The Lawyers Weekly*, October 29, 2004.

93 But see the discussion of the provisions of the Canada-US tax treaty below, under the heading "Assistance in Collection."

94 [1963] SCR 366.

95 Ibid., at 368.

96 Ibid., at 369.

97 [1955] AC 491 (HL).

98 (1923), 16 Ll. LR 190, at 193 (KB).

> One explanation of the rule thus illustrated may be thought to be that enforcement of a claim for taxes is but an extension of the sovereign power which imposed the taxes, and that an assertion of sovereign authority by one State within the territory of another, as distinct from a patrimonial claim by a foreign sovereign, is (treaty or convention apart) contrary to all concepts of independent sovereignties. Another explanation has been given by an eminent American judge, Judge Learned Hand, in the case of *Moore v. Mitchell*, in a passage, quoted also by Kingsmill Moore J. in the case of *Peter Buchanan Ltd.* as follows:
>
>> While the origin of the exception in the case of penal liabilities does not appear in the books, a sound basis for it exists, in my judgment, which includes liabilities for taxes as well. Even in the case of ordinary municipal liabilities, a court will not recognize those arising in a foreign State, if they run counter to the "settled public policy" of its own. Thus a scrutiny of the liability is necessarily always in reserve, and the possibility that it will be found not to accord with the policy of the domestic State. This is not a troublesome or delicate inquiry when the question arises between private persons, but it takes on quite another face when it concerns the relations between the foreign State and its own citizens or even those who may be temporarily within its borders. To pass upon the provisions for the public order of another State is, or at any rate should be, beyond the powers of the court; it involves the relations between the States themselves, with which courts are incompetent to deal, and which are intrusted to other authorities. It may commit the domestic State to a position which would seriously embarrass its neighbour. Revenue laws fall within the same reasoning; they affect a State in matters as vital to its existence as its criminal laws. No court ought to undertake an inquiry which it cannot prosecute without determining whether those laws are consonant with its own notions of what is proper.
>
> On either of the explanations which I have just stated I find a solid basis of principle for a rule which has long been recognized and which has been applied by a consistent train of decisions. It may be possible to find reasons for modifying the rule as between States of a federal union. But that consideration, in my opinion, has no relevance to this case.[99]

Cartwright J concluded his analysis of this issue by citing the definition of the revenue rule enunciated by Lord Somerville of Harrow in *Taylor*, who described it as "the special principle that foreign States cannot directly or indirectly enforce their tax claims here."[100] Cartwright J then specifically dismissed the position of the appellant that the enforcement of a judgment should be an exception to the rule:

> In my opinion, a foreign State cannot escape the application of this rule, which is one of public policy, by taking a judgment in its own courts and bringing suit here on that judgment. The claim asserted remains a claim for taxes. It has not, in our courts, merged in the judgment; enforcement of the judgment would be enforcement of the tax claim.[101]

99 *Taylor*, supra note 97, at 511-12.

100 Ibid., at 515.

101 *Harden*, supra note 94, at 371.

I anticipate that with the increasing trend toward judicial comity, the Supreme Court of Canada will be asked to revisit the revenue rule in the not too distant future. Ultimately, however, it should be recognized that the United States appears to have a much greater stake in seeing the demise of the revenue rule than any other nation in the world. The reason is obvious. The United States is the only nation that bases tax liability on citizenship, and there are countless US citizens spread out across the globe, each of whom remains subject to certain filing obligations, regardless of residence.

The magnitude of the issue for the US government was alluded to in *Chua v. MNR*,[102] in connection with the negotiation of the third protocol to the Canada-US tax treaty and specifically the need for inclusion in that protocol of a bilateral enforcement mechanism. The court noted:

> An estimated 2.3 million U.S. citizens, excluding military and official U.S. personnel, lived outside the United States in 1990, but in that year, fewer than 250,000 returns were filed. The U.S. was also concerned about the effects of the decision of the Supreme Court of Canada in *United States of America v. Harden*, [1963] S.C.R. 366, which limited the ability of the U.S. authorities to enforce a U.S. tax judgment in Canada.[103]

Although a number of commentators have called for the repeal of the revenue rule, and others have predicted its downfall or at least a relaxation of its strictures, it still remains the law in Canada. Accordingly, subject to resort to the assistance-in-collection provisions of the Canada-US tax treaty (discussed below), any request by the United States for the enforcement by a Canadian court of a judgment involving a taxing statute appears to be doomed, at least for the time being.

Fines and Penalties

Another well-entrenched common-law doctrine is the so-called penal rule. This doctrine stands for the proposition that no Canadian court will enforce, either directly or indirectly, a judgment for a fine or penalty under a foreign penal law.[104] In addition, there has been some hesitancy on the part of Canadian courts to give effect to certain foreign non-penal public laws.[105] This "public-law rule," however, does not appear to apply to restitutionary orders.[106]

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102 [2001] 1 FC 608 (TD).

103 Ibid., at paragraph 15.

104 *Pro Swing Inc.*, supra note 59, at paragraph 10, citing *Dicey and Morris on the Conflict of Laws*, 13th ed., vol. 1 (London: Sweet & Maxwell, 2000), rule 35, at 474-75.

105 That is, in addition to revenue and penal statutes; see Castel and Walker, supra note 77, at paragraph 8.5.

106 See *United States of America v. Ivey*, 1995 CanLII 7241 (Ont. Gen. Div.). In this case, the United States sought to enforce a judgment under the federal Comprehensive Environmental Response, Compensation and Liability Act for reimbursement of costs of remedial measures by a government agency for a waste disposal site owned and operated by the defendants, who were

The following definition of "penal law" from Castel and Walker, *Canadian Conflict of Laws*, was affirmed by McLachlin CJ in a dissenting opinion in *Pro Swing Inc.*:

> A penal law is a law that imposes a punishment for a breach of a duty to the state—as opposed to a remedial law, which secures compensation for a breach of a duty owed to a private person. . . . Liability that is restitutionary in nature and that is not imposed with a view to punishment of the party responsible is not regarded as penal in nature.[107]

The basic idea is that penal orders deal with public law as opposed to the enforcement of foreign civil judgments, which are within the realm of private international law.[108] As we have already seen, the concept of judicial comity in matters of private international law has become quite settled, and courts are generally willing to enforce judgments within that sphere. However, since any action for enforcement of FBAR and FATCA penalties would, by definition, violate the penal rule as it relates to public law and wrongs against a foreign state, it appears that, absent a Supreme Court reversal of the common law in that regard, no Canadian court could enforce a US judgment within this latter sphere.

Constitutional Law Considerations

Section 32 of the Canadian Charter of Rights and Freedoms[109] limits the application of the Charter to actions taken by Parliament, the government of Canada, a provincial legislature, or a provincial government.[110] Thus, and in keeping with principles of international comity, the Charter generally cannot apply extraterritorially.[111] It is clear that on a strict reading of section 32, the provisions of a foreign law cannot be subject to Charter scrutiny as being ultra vires the enacting state.[112] However, as guardians of Canadian constitutional values, Canadian courts have the jurisdiction, as a matter of public policy, to raise the issue as to whether the enforcement of a foreign judgment would violate the defendant's Charter rights.[113] As noted earlier,

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resident in Canada. The court held that neither the penal- nor public-law rules should apply to bar enforcement since the measure of recovery was tied directly to the costs of the cleanup and therefore not penal in nature.

107 Castel and Walker, supra note 77, at paragraph 8.2, quoted in *Pro Swing Inc.*, supra note 59, at paragraph 100.

108 *United States Securities and Exchange Commission v. Cosby*, 2000 BCSC 338, at paragraph 19.

109 Canadian Charter of Rights and Freedoms, part I of the Constitution Act, 1982, being schedule B to the Canada Act 1982 (UK), 1982, c. 11 (herein referred to as "the Charter").

110 *Schreiber v. Canada (Attorney General)*, [1998] 1 SCR 841, at paragraph 31.

111 *United States v. Dynar*, [1997] 2 SCR 462, at paragraph 123.

112 Not surprisingly, this will not be the case where both the foreign jurisdiction and the reviewing jurisdiction are provinces of Canada (see *Hunt v. T&N plc*, infra note 145), since in such a case what is involved is a Charter inquiry on a Canadian law.

113 *Pro Swing Inc.*, supra note 59, at paragraph 59.

in the context of the public policy defence, a challenge on this basis would be difficult to surmount.

It is clear that the requirements imposed on FFIs under FATCA constitute an attempt on the part of the United States to cast a massive net across the globe in the hope of pulling in a bounty of "fish." The regime is not unlike the FBAR legislation enacted in a domestic context more than 40 years ago. It should be noted, however, that the constitutionality of the FBAR record-keeping and reporting requirements established by the BSA was challenged on two separate occasions on the basis that this law violated the fourth amendment to the US constitution, which provides guarantees against unreasonable search and seizure.[114] In both cases, the US Supreme Court upheld the constitutionality of the legislation, although with a strong dissent from Marshall J in both instances.

In determining whether the FFI disclosure requirements would be constitutional under the Charter, we may best resort to an examination by analogy. It is suggested that the body of case law that has built up around what is now section 231.2 of the ITA provides an apt analogy for present purposes. That section sets out the minister's authority to require the provision of documents or other information.

The leading case on this point is *James Richardson & Sons v. MNR*.[115] In *Richardson*, the Supreme Court was asked to assess the constitutionality of a request for information issued by the minister to a broker under what was then subsection 231(3) of the ITA. That section provided that the minister had the power to demand from any person "production of any books, letters, accounts, invoices, statements (financial or otherwise) or other documents" provided that the requested information was required for the proper administration and enforcement of the ITA.

The request for information at issue was addressed to a broker trading in the commodities futures market in Winnipeg. The production requested was the appellant's magnetic tape file of its clients' commodity monthly statements for 1977 so that the minister could process the information on a "test basis." The information was supplied, but with account numbers only, so that it was impossible to determine the identities of those involved. In response to the disclosure, the minister asked for a complete listing of the names and addresses of the accountholders together with their individual account numbers.

The court stated:

> It seems to me that what the Minister is trying to do here, namely check generally on compliance with the statute by traders in the commodities futures market, cannot be done by conducting a "fishing expedition" in the affairs of one broker's customers under s. 231(3) of the Act.[116]

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114 See *California Bankers Assn. v. Shultz*, 416 US 21 (1974); and *United States v. Miller*, 425 US 435 (1976).

115 [1984] 1 SCR 614.

116 Ibid., at 625.

As the Federal Court of Appeal recently noted, the decision of the Supreme Court in *Richardson*

> confirmed that a demand could only be made for information relative to the tax liability of a person or persons under the former subsection 231(3) of the Act if a genuine and serious inquiry was being conducted into the tax liability of such person or persons.[117]

Accordingly, the section did not authorize a general survey of compliance by a class of taxpayers. As a direct result of the decision in *Richardson*, the legislation was changed to provide that no third party could be compelled to provide information or any document relating to one or more unnamed persons without the authorization of a judge.[118]

In *R v. He*,[119] a very recent case relating to subsection 230(1) of the ITA,[120] the minister sent a letter informing the plaintiff company of its selection for consideration by the CRA's electronic evaluation pilot project. The defendant's business was one of 300 that had been targeted for research into compliance issues relating to the maintenance and retention of electronic records. The business owner advised CRA officers that he was not interested in participating. A short time later, CRA officials attended at the place of business and copied data from a point-of-sale computer program onto a USB key and seized a number of diskettes, relying on the inspection powers set out under section 231.1 of the ITA.

After a review of the data, criminal charges were laid against the business. The court applied the test in *Richardson* and concluded that the CRA was not "engaged in a genuine and serious inquiry into the tax liability of the defendants."[121] Thus, the seizure of the material was unlawful, amounted to a warrantless seizure of the electronic data, and, as such, breached the defendant's section 8 Charter rights (protection from unreasonable search and seizure). As a consequence of the section 8 breach, the evidence was excluded by application of section 24 of the Charter.

A review of the case law that began with *Richardson* appears to confirm that in order for a forced disclosure of taxpayer information to be on firm constitutional ground, the inquiry must be bona fide and conducted for the purposes of determining the tax liability of the person involved. Thus, it is submitted, the *Richardson* line of cases strongly suggests that the FFI disclosure requirements imposed under FATCA would not be within the power of the Canadian legislature to enact. Specifically, it is

117 *Canada (National Revenue) v. Greater Montréal Real Estate Board*, 2007 FCA 346, at paragraph 25.

118 See current ITA subsection 231.2(2).

119 2011 BCSC 368; leave to appeal granted 2011 BCCA 360.

120 ITA subsection 230(1) requires the maintenance of records and books of account by all persons carrying on a business.

121 *He*, supra note 119, at paragraph 37 (BCSC).

clear that this portion of the FATCA law amounts to nothing more than a fishing expedition to the extent that compulsory reporting relating to the nature and extent of a taxpayer's assets would not be relevant to an inquiry into the tax liability of the taxpayer, and thus would violate section 8 of the Charter. Put another way, the amount of cash held in a foreign bank account is relevant to tax liability only to the extent that such an asset earns income. By requiring an FFI to disclose the nature and extent of a taxpayer's assets, arguably the FATCA law crosses the line from legitimate inquiry into matters relating to tax liability and becomes a full-scale fishing expedition.

As noted above, however, this conclusion is relevant to the potential enforcement of FATCA claims only to the extent that it might violate Canadian public policy. The fact that the FATCA law or certain parts of it might not pass Charter scrutiny is not relevant other than providing an indication that the impugned portions of the FATCA regime may be void as being contrary to Canadian public policy.

We are therefore left with the strange result that Canadian courts could be asked to enforce fines and penalties that have been imposed on certain residents of Canada on the basis of information that our own revenue agency might not lawfully be able to obtain. At this stage, since the revenue, penal, and public law exceptions would likely preclude recourse to the courts for FATCA and/or FBAR claims, the question as to whether the FATCA FFI disclosure law is constitutional is moot. The question becomes more of an issue in the context of the Canada-US tax treaty, as discussed below.

Canada-US Tax Treaty

The Canada-US tax treaty was signed on September 26, 1980, thereby replacing the prior 1942 treaty. Since its inception, the treaty has been amended through the ratification of five protocols, the last of which was signed on September 21, 2007 and came into force on December 15, 2008. The treaty was incorporated into Canadian law by the Canada-United States Tax Convention Act, 1984.[122]

As is generally understood, the main purpose of the treaty at the time it was enacted was to reduce or eliminate double taxation and to "mitigate the administrative complexities occasioned by having to file simultaneously income tax returns in two uncoordinated taxation systems."[123] Since its enactment, the treaty has evolved to recognize other pressing matters, including issues associated with cross-border transactions in the context of the treaty's stated mandate to prevent "fiscal evasion with respect to taxes."[124] Notable among these newer provisions are the assistance-in-collection and exchange-of-information articles.

122 SC 1984, c. 20.

123 *Crown Forest Industries Ltd. v. Canada*, [1995] 2 SCR 802, at paragraph 46.

124 See the preamble to the Canada-US tax treaty.

Assistance in Collection

It may well have been the decision of the Supreme Court in *Harden* that led the United States to push for the adoption of article XXVI A of the Canada-US tax treaty.[125] Article XXVI A is entitled "Assistance in Collection" and was added by article 15 of the third protocol to the treaty, signed on March 17, 1995.[126] The protocol provided that article XXVI A was to apply retroactively; as a result, the assistance-in-collection provisions applied to claims dating back as far as November 10, 1985.[127]

In the words of one commentator,

> [t]he entry into force of these provisions will effectively override the otherwise firmly entrenched principle of international law described above. No longer will a US citizen be permitted to move to Canada and avoid his or her US tax liabilities as in *Harden*.[128]

Indeed, a reading of the assistance-in-collection provisions appears to confirm the commentator's statement—*unless* the US citizen is also a Canadian citizen. Paragraph 8 of article XXVI A provides that no assistance in collection will be provided for a revenue claim in respect of a taxpayer if the taxpayer was a citizen of the requested state at the relevant time. Accordingly, the treaty is of no effect in the case of dual US-Canadian citizens.

Another important limitation in the article is a provision that affirms the minister's discretion to refuse a request for assistance in collection.[129]

Paragraph 1 of article XXVI A sets out the broad agreement to provide assistance in collection, as follows:

> The Contracting States undertake to lend assistance to each other in the collection of taxes referred to in paragraph 9, *together with interest*, *costs*, *additions to such taxes and civil penalties*, referred to in this Article as a "revenue claim" [emphasis added].

This is important for present purposes in that it *appears* to overcome the problems associated with the penal rule.[130]

125 Dianne Bennett, "Third Protocol to the Canada-US Tax Treaty," in *Report of Proceedings of the Forty-Seventh Tax Conference*, 1995 Conference Report (Toronto: Canadian Tax Foundation, 1996), 44:1-25, at 44:10.

126 Debenham, supra note 84; and Castel and Walker, supra note 77, at paragraph 8.5, note 25.

127 Article 21(3) of the third protocol to the Canada-US tax treaty, and Bennett, supra note 125.

128 Stephen S. Heller, "Enforcement of Foreign Tax Judgments: Implications of the Recent Canada-US Protocol," in *Report of Proceedings of the Forty-Sixth Tax Conference*, 1994 Conference Report (Toronto: Canadian Tax Foundation, 1995), 2:103-14, at 2:110.

129 Paragraph 3 of article XXVI A states that a revenue claim of the applicant state that has been finally determined *may* be accepted for collection.

130 But see below under the heading "Interpretation of the Treaty."

Paragraph 9 states:

> Notwithstanding the provisions of Article II (Taxes Covered), the provisions of this Article shall apply to all categories of taxes collected, and to contributions to social security and employment insurance premiums levied, by or on behalf of the Government of a Contracting State.

Article II provides:

> 1. This Convention shall apply to taxes on income and on capital imposed on behalf of each Contracting State, irrespective of the manner in which they are levied.
>
> 2. Notwithstanding paragraph 1, the taxes existing on March 17, 1995 to which the Convention shall apply are:
>
> (a) In the case of Canada, the taxes imposed by the Government of Canada under the *Income Tax Act*; and
>
> (b) In the case of the United States, the Federal income taxes imposed by the *Internal Revenue Code* of 1986. However, the Convention shall apply to:
>
> (i) The United States accumulated earnings tax and personal holding company tax, to the extent, and only to the extent, necessary to implement the provisions of paragraphs 5 and 8 of Article X (Dividends);
>
> (ii) The United States excise taxes imposed with respect to private foundations, to the extent, and only to the extent, necessary to implement the provisions of paragraph 4 of Article XXI (Exempt Organizations);
>
> (iii) The United States social security taxes, to the extent, and only to the extent, necessary to implement the provisions of paragraph 2 of Article XXIV (Elimination of Double Taxation) and paragraph 4 of Article XXIX (Miscellaneous Rules); and
>
> (iv) The United States estate taxes imposed by the *Internal Revenue Code* of 1986, to the extent, and only to the extent, necessary to implement the provisions of paragraph 3(g) of Article XXVI (Mutual Agreement Procedure) and Article XXIX B (Taxes Imposed by Reason of Death).
>
> 3. The Convention shall apply also to:
>
> (a) Any taxes identical or substantially similar to those taxes to which the Convention applies under paragraph 2; and
>
> (b) Taxes on capital;
>
> which are imposed after March 17, 1995 in addition to, or in place of, the taxes to which the Convention applies under paragraph 2.

Thus, it is clear that the treaty applies to all "Federal income taxes imposed by the Internal Revenue Code of 1986." The limitations set out in paragraphs (2)(b)(i) through (iv) would certainly not apply to FBAR or FATCA.

Exchange of Information—Prohibition of Fishing Expeditions

In addition to the inclusion of the assistance-in-collection provisions, the third protocol expanded the scope and availability of the exchange-of-information provisions in article XXVII. This was of particular concern to the United States. The US

Treasury department felt that it needed more information and weapons to effect compliance with the voluntary tax system.[131]

One commentator, however, has recently noted the limitations of article XXVII in combatting tax evasion:

> There are two broad approaches to exchanging tax information between countries. The traditional way is for countries to negotiate bi-lateral exchange of information articles within their double taxation treaties. Canada for example, has such a provision with the United States. The provision, however, is cumbersome and does not allow for "fishing expeditions." The CRA must ask for specific information about a specific taxpayer and endure all manner of judicial procedural safeguards, which makes the provision inconvenient and cumbersome.[132]

FATCA appears to overcome this obstacle insofar as one of the main purposes of the FFI reporting regime, if not its entire raison d'être, is the legitimization of a fishing expedition the scale of which has likely never been seen before.

Absent FATCA, article XXVII would be of little value to the United States in collecting information on assets held by Canadian FFIs since such information would not likely be in the possession of the CRA. Although paragraph 2 of article XXVII provides that a contracting state "shall use its information gathering measures" to accommodate the requesting state in the event that the information requested is not in the possession of the requested state, paragraph 3 eliminates this obligation where implementation of these measures would be contrary to the laws of the requested state. As discussed above, in my view the use of the information-gathering tools provided in the ITA for these purposes would be considered unconstitutional.

Interpretation of the Treaty

It is fairly obvious that fines and penalties imposed under the FBAR and FATCA individual reporting requirements cannot themselves be properly characterized as "taxes" for the purposes of the assistance-in-collection provisions. Thus, the question becomes whether these fines and/or penalties are at all capable of forming the basis of a revenue claim under the treaty.

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131 See *Chua*, supra note 102, at paragraph 15.

132 Vern Krishna, "It's Getting Harder for Tax Evaders," *National Post*, December 14, 2011. An earlier commentator, however, defended this limitation, as follows: "A significant amount and/or principle should be involved before a request for information is initiated. The information sought should be of a kind which could realistically be expected to be obtained in the ordinary course of an audit. In other words, the exchange-of-information article must not be used as a means of embarking on 'fishing expeditions.'" Carole Gouin, "International Tax Compliance: Revenue Canada's Perspective," in *Report of Proceedings of the Forty-Eighth Tax Conference*, 1996 Conference Report, vol. 2 (Toronto: Canadian Tax Foundation, 1997), 40:1-9, at 40:5.

In the case of FBAR, since the BSA is clearly not a taxing statute, any fees or penalties imposed under the FBAR rules should not fall within the purview of the treaty.[133] Accordingly, the issue stated above relates only to FATCA and, it is asserted, reduces to one of pure interpretation.

The language of paragraph 1 of article XXVI A is capable of two distinct interpretations. The first would view the words "together with" as suggesting that a revenue claim is capable of consisting of (1) a pure tax component and/or (2) a pure punitive and interest component. The second would view "together with" as indicating that any individual component of the class "interest, costs, additions to such taxes and civil penalties" could form only a *portion* of a revenue claim as ancillary to the main function (the collection of taxes)—in other words, as a mere adjunct thereof. Clearly, if the second interpretation is embraced, the FATCA penalties for individuals who fail to file could not be the subject of a revenue claim under the treaty since they are stand-alone claims—that is, claims for administrative penalties not tied to an actual tax debt.

Unfortunately, neither the Income Tax Conventions Interpretation Act[134] nor the US Treasury department's technical explanation of the third protocol[135] is instructive in determining which of the foregoing interpretations applies. However, the leading Canadian authority on the interpretation of tax treaties, *Crown Forest Industries Ltd.*,[136] is instructive. In that case, a unanimous Supreme Court stated:

> Clearly, the purpose of the Convention has significant relevance to how its provisions are to be interpreted. I agree with the intervener Government of the United States' submission that, in ascertaining these goals and intentions, a court may refer to extrinsic materials which form part of the legal context (these include accepted model conventions and official commentaries thereon) without the need first to find an ambiguity before turning to such materials. . . .
>
> Of high persuasive value in terms of defining the parameters of the *Canada-United States Income Tax Convention (1980)* is the OECD *Model Double Taxation Convention on Income and on Capital* (1963, re-enacted in 1977).[137]

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133 This has recently been confirmed in CRA document no. 2011-0431621M4, March 6, 2012, which states, "The treaty has a provision that requires Canada Revenue Agency (CRA) to assist in collecting certain U.S. taxes and penalties. Nevertheless, the provision does not include the collection of penalties related to the FBAR."

134 RSC 1985, c. I-4, as amended.

135 United States, Department of the Treasury, Technical Explanation of the Protocol Amending the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital, released by the Treasury Department on June 13, 1995.

136 Supra note 123.

137 Ibid., at paragraphs 44 and 55.

Annex A to the fifth protocol of the treaty[138] provides structure to the mutual agreement procedure set out in article XXVI of the treaty. The mutual agreement procedure is the dispute resolution provision. Most notably, section 9 of annex A states:

> In making its determination, the arbitration board shall apply, as necessary: (1) the provisions of the Convention as amended; (2) any agreed commentaries or explanations of the Contracting States, concerning the Convention as amended; (3) the laws of the Contracting States to the extent they are not inconsistent with each other; and (4) any OECD Commentary, Guidelines or Reports regarding relevant analogous portions of the OECD Model Tax Convention.

This statement is consistent with the comments of the Supreme Court cited above. Thus, it is appropriate to look to the commentary on treaty interpretation issued by the Organisation for Economic Co-operation and Development (OECD), as an interpretive aid.[139] The OECD *Manual on the Implementation of Assistance in Tax Collection* states:

> According to the commentary to Article 27, paragraph 2 of the OECD Model Convention, "revenue claim" refers to any amount owed in respect of all taxes that are imposed on behalf of the contracting states, or of their political subdivisions or local authorities, but only insofar as the imposition of such taxes is not contrary to the Convention or other instrument in force between the contracting states. It also applies to the interest, administrative penalties and costs of collection or conservancy *that are related to such an amount*.[140]

Thus, it appears that under the OECD model, administrative penalties must be related to an underlying tax claim. However, the manual further states:

> If the amount of tax owed has been paid, there may still be interest or charges left to be collected. In the domestic law of most countries, claims consisting only of interest, fines or costs are also tax claims and are collected as such. Provided that the legal instrument forming the basis of the assistance in collection does not have a narrower

138 Protocol Amending the Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital Done at Washington on 26 September 1980, as Amended by the Protocols Done on 14 June 1983, 28 March 1984, 17 March 1995 and 29 July 1997, signed at Chelsea, Quebec on September 21, 2007 and ratified by Canada on December 14, 2007.

139 Indeed, in addition to the judgment of the Supreme Court in *Crown Forest Industries Ltd.*, supra note 123, the courts have on numerous occasions affirmed the principle that reference to OECD commentaries is relevant to the interpretation of tax treaties: see, for example, *Canada v. Prévost Car Inc.*, 2009 FCA 57, at paragraph 10; and *Dudney v. R*, [2000] 2 CTC 56, at paragraph 10 (FCA).

140 Organisation for Economic Co-operation and Development, *Manual on the Implementation of Assistance in Tax Collection*, approved by the OECD Committee on Fiscal Affairs on January 26, 2007 (Paris: OECD, 2007), General Module, part I, at paragraph 21 (emphasis added).

> definition of what is a tax claim, there should be nothing preventing a claim concerning only interest to become the subject of a request for assistance. This applies even if the underlying tax claim has been collected in the applicant state without the use of international assistance. In certain countries though, the issue does not arise as rules of imputation stipulate that the amount of the tax debt itself is discharged after the payment of expenses and interest.[141]

Although this second paragraph seems to suggest that stand-alone claims for administrative penalties are contemplated under the model, the interpretation it sets out is predicated on the concept of an "underlying tax claim"; accordingly, it can be argued that the OECD commentary further bolsters the second interpretation of paragraph 1, article XXVI A, suggested above—that stand-alone claims for administrative penalties are not capable of being characterized as revenue claims.

In light of the foregoing, it is suggested that, purely on the basis of statutory interpretation, the Canada-US treaty can provide no assistance to the United States in seeking to enforce penalties for failure to comply with the individual reporting requirements of either FBAR or FATCA.

Constitutional Law Considerations

Another factor to consider is the applicability of the Charter to the assistance-in-collection provisions. As stated previously, since the Charter only governs Canadian governmental activities, at first glance it does not appear relevant that the FATCA FFI disclosure requirements would be unlikely to pass Charter scrutiny. However, it is important to note the language of paragraph 4(b) of article XXVI A, which states:

> 4. Where an application for collection of a revenue claim in respect of a taxpayer is accepted . . .
>
> b. By Canada, the revenue claim shall be treated by Canada as an amount payable under the *Income Tax Act*, the collection of which is not subject to any restriction.

Thus, a revenue claim is deemed to be an amount payable under the ITA, and the Charter is activated at least with respect to the collection of the claim.[142] The "fruit of the poisoned tree" doctrine is not likely applicable to the collection process since it holds that "past wrongs preclude the Crown from subsequently benefiting from them."[143] Where Canada (the Crown) is assisting the United States under article XXVI A(4), it is not the Crown or any of its agents that has committed a "wrong" in conducting a fishing expedition, but rather the United States.

Still, as noted above, the minister has the discretion to refuse assistance in collection. Certainly from a public policy standpoint, it must be relevant that the

141 Ibid., at paragraph 26.

142 Since the CRA is an administrative branch of the federal government, the Charter applies to its actions: see *RWDSU v. Dolphin Delivery Ltd.*, [1986] 2 SCR 573, at paragraph 33.

143 *Rio Tinto Alcan Inc. v. Carrier Sekani Tribal Council*, 2010 SCC 43, at paragraph 54.

Crown, in providing collection assistance on a FATCA revenue claim, would in many cases be acting against its own taxpayers in the enforcement of a claim founded upon information obtained in a manner that may not be constitutional under the laws of Canada. The Crown is not obliged to do anything contrary to the public policy of Canada in collecting a revenue claim under the treaty.[144] This last point is analogous to the common-law public policy defence discussed above.

The situation that arises is not unlike that before the Supreme Court in *Hunt v. T&N plc*,[145] except that the *Hunt* case dealt with the question of the constitutionality of a Quebec blocking law in the context of a class action tort claim brought in British Columbia. The court held in that case:

> The policy reasons for allowing consideration of constitutional arguments in determining foreign law that incidentally arises in the course of litigation are well founded. The constitution of another jurisdiction is clearly part of its law, presumably the most fundamental part. A foreign court in making a finding of fact should not be bound to assume that the mere enactment of a statute necessarily means that it is constitutional. *Formal determination of constitutionality is often purely fortuitous. It is often dependent on there happening to be parties interested in challenging the statute. This is unlikely to happen where, as in this case, most of the parties affected are outside the enacting jurisdiction*. In this case, the Quebec statute has never been challenged by Quebec litigants because it does not arise in normal litigation in the province, and in extraprovincial litigation, Quebec defendants benefit while Quebec plaintiffs are normally unaffected. Why should a litigant not be able to argue constitutionality in the course of litigation that directly raises the issue? As a practical matter, it is not much more difficult to determine constitutionality than any other aspect of foreign law.[146]

Clearly, the constitutionality of the FATCA FFI disclosure regime is not likely to be challenged in the United States, for reasons similar to the impugned Quebec law in *Hunt*. In *Hunt*, La Forest J, writing for a unanimous court, cited the English cases of *Buck v. Attorney General*[147] and *Manuel v. A-G*[148] for the proposition that courts of one country should not pronounce on the validity of a statute of another *unless* the question as to constitutionality is incidental to the litigation.[149]

It therefore applies that the decision in *Hunt* would apply to a challenge brought by a taxpayer in Canada facing the enforcement of a FATCA fine or penalty based on information obtained through the fishing expedition carried out by means of the

144 See article XXVI A(10)(b) of the Canada-US tax treaty. See also *Chua*, supra note 102, at paragraph 43.

145 [1993] 4 SCR 289.

146 Ibid., at paragraph 29 (emphasis added).

147 [1965] 1 All ER 882 (CA).

148 [1982] 3 All ER 786 (Ch. D.).

149 *Hunt*, supra note 145, at paragraph 28.

FATCA FFI disclosure regime. The main part of such a challenge would likely involve an attack on the enforcement process conducted by the CRA; incidental to the challenge would be the constitutionality of the fishing expedition that provided the IRS with the information on the basis of which the FATCA penalties were imposed. A Canadian court would therefore be called upon to determine the constitutionality of the law compelling the FFI disclosure, presumably under the US constitution.

Such a challenge would likely be brought by way of judicial review of the minister's decision to assist the United States in the collection of the revenue claim. The standard for review would be that of "unreasonableness."[150] The application could be brought under section 18.1 of the Federal Courts Act.[151] It has been established that the Federal Court has jurisdiction to deal with constitutional challenges on an application for judicial review under section 18.1.[152]

As stated previously, it is anticipated that the constitutional matter would not have to be adjudicated, as a result of the interpretation proposed above that revenue claims under the Canada-US tax treaty cannot be made for stand-alone penalties that are not tied to an underlying tax. In any event, the challenge would not be the first time that the Federal Court had heard an application for judicial review arising out of the interpretation of a provision of the treaty.[153]

MUSINGS ON THE MOTIVATION BEHIND THE ENACTMENT OF FATCA

A natural question to ask is why the United States needs FATCA individual reporting requirements when it already has FBAR. While some of FATCA's individual reporting requirements are similar to FBAR, FATCA applies to a wider range of assets, including investments in foreign hedge funds and private equity funds.[154] So if FATCA's scope is greater, why retain FBAR?

The motivation on the part of the United States in enacting FATCA is not mysterious. There can be little doubt that FATCA was designed to replace FBAR as a means of both tracking information and levying fines and penalties. It is fairly clear that the United States has found FBAR to be an antiquated and ineffective tool to achieve these ends.

150 *Canada Revenue Agency v. Telfer*, 2009 FCA 23, at paragraph 24.

151 RSC 1985, c. F-7, as amended. Section 18.1(4)(c) of the Federal Courts Act provides that the Federal Court may quash a decision of a federal board, commission or other tribunal (including the minister) on the basis that the decision maker erred in law in making a decision or an order, whether or not the error appears on the face of the record.

152 *Gwala v. Canada*, [1999] 3 FC 404, at paragraph 6 (CA).

153 See *Kubicek Estate v. R*, [1997] 3 CTC 435 (FCA), where the minister sought judicial review of a decision of the Tax Court of Canada in connection with the Tax Court's interpretation of the term "gain" for the purposes of article III(2) of the treaty.

154 Kevin E. Packman and Mauricio D. Rivero, "The Foreign Account Tax Compliance Act: Taxpayers Face More Disclosures and Potential Penalties" (2010) 210:2 *Journal of Accountancy* 44.

The two major deficiencies that one can identify with the FBAR regime on its face are (1) the fact that it is not capable of enforcement outside the United States; and (2) without information collection, FBAR is a very blunt tool. In the enactment of the FATCA law, the United States has addressed each of these issues and has honed its punitive sword. Since the individual disclosure component of FATCA is now embedded within the IRC, subject to the comments above with respect to statutory interpretation, the Canada-US tax treaty might well apply; thus, the United States could potentially seek to have FATCA enforced in Canada and other nations with which it has negotiated similar assistance-in-collection provisions. Further, coupled with the financial institution disclosure contemplated, the individual disclosure requirements of FATCA provide a very sharp tool indeed if one of the purposes of the regime is to raise money through the imposition of fines and penalties.

Reading between the lines of the statute, it could be inferred that the legislative intent behind the enactment of the FATCA regime is not merely (or even primarily) the collection of information. It could well be inferred that FATCA is meant to serve a revenue-generating role as well, but not in the traditional sense. Clearly, the punitive measures contained within the law with respect to an individual's failure to file could be viewed merely as an inducement to comply and therefore to enhance the efficacy of FATCA's information-gathering function. Indeed, there is no doubt that this is one of the objectives of the penalty provisions. However, it is also quite possible, and perhaps probable, that FATCA is in equal part both an information-gathering tool and a revenue-generating tool. It is for this reason that FBAR will never go away. With information garnered from FATCA FFI reports, penalties can be levied under both FATCA and FBAR if an individual fails to file. However, as we have noted, the long arm of the IRS cannot reach Canada with respect to FBAR, and as further posited, it is likely that FATCA penalties would also be unenforceable in Canada.

From the US perspective, the best-case scenario would see all financial institutions around the globe complying with the strictures of the disclosure requirement. Armed with the massive list that would be generated from such compliance, the IRS would merely have to check names against received disclosures and levy fines against those individuals who had not complied. Carrying this scenario further, the IRS could then, after the exhaustion of all administrative appeal periods and recourse,[155] approach the minister of national revenue with a list of individuals owing FATCA penalties and ask that those penalties be enforced by the CRA under the terms of the Canada-US tax treaty. It is assumed that in a large number of cases, a notice from the IRS to an individual noting lack of FATCA compliance would not be responded to, and in those cases, a penalty of $50,000 would be levied, thereby raising a very significant amount of revenue.

155 Paragraph 2 of article XXVI A of the Canada-US tax treaty provides that no revenue claim can be made under the treaty unless it has been "finally determined" within the jurisdiction of the requesting state.

The foregoing presupposes the full cooperation of the requested state under its assistance-in-collection treaty provisions. In the case of the Canada-US tax treaty, as noted previously, the minister has the discretion to decide whether or not to assist the United States with collection in a particular case. The existence of this discretion provides a very real threat to the best-case scenario envisioned above. Another significant factor that could interfere with US hopes is potential diplomatic and political resistance on the part of the federal government of Canada to the financial institution disclosure protocol set out in FATCA. These two threats are intertwined, since the ministerial discretion to assist as set out in the treaty provides the government with a significant bargaining chip that it can use in negotiations with the United States regarding relaxation of the FATCA reporting requirements for the Canadian financial and banking industries. In short, the Canadian government could advise the United States that without some compromise in the application of FATCA as regards Canada, the United States should not expect any cooperation under the treaty in the collection of fines and penalties. Indeed, Canada could avoid a potential reciprocity war by simply advising the United States that FATCA penalties cannot fall within revenue claims under the treaty, on the basis of the interpretation set forth in this article.

The public face of FATCA is its function as an information-gathering tool.[156] As Canada's finance minister has emphatically and correctly stated, Canada is not a tax haven.[157] There is little doubt that FATCA was not designed with Canada in mind; there is no tax revenue to be garnered here, owing to the existence of the foreign earned income exclusion and the foreign tax credit[158] within the IRC and Canada's higher marginal tax rates relative to the United States. Still, one can certainly appreciate that the best-case scenario from the US perspective would have FATCA applied uniformly worldwide. Clearly, making exceptions on a nation-by-nation basis could compromise the integrity of the entire regime. However, one cannot discount the adverse impact that compliance with FATCA would have on the Canadian financial and banking industries in terms of compliance costs alone. With that in mind, along with the fact that FATCA has been marketed as an information-gathering tool, there is a strong argument that the United States should relax its requirements as regards Canada, if not release them entirely.

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156 The stated purpose of the new law is to "clamp down on tax evasion and improve taxpayer compliance by giving the Internal Revenue Service new administrative tools to detect, deter and discourage offshore tax abuses": see Dean Marsan, "FATCA: The Global Financial System Must Now Implement a New U.S. Reporting and Withholding System for Foreign Account Tax Compliance, Which Will Create Significant New Exposures—Managing This Risk (Part I)" (2010) 88:7 *Taxes: The Tax Magazine* 27-92, at 38.

157 See the text of an open letter from Finance Minister Jim Flaherty reprinted in "Flaherty Weighs In on U.S. Bank Proposals" (2011) 33:19 *The Canadian Taxpayer* 148-49.

158 IRC section 911.

If, however, as suggested above, the United States also views FATCA as serving a valuable revenue-generating purpose through the imposition of fines and penalties, presumably the United States will not be moved to make any exceptions for Canada. It is precisely for that reason that Canada should not accede to the whims of the Americans, since that second, hidden purpose is simply bad tax policy. It is trite to say that the purpose of taxing legislation should not be primarily punitive in nature; rather, such legislation should seek to collect revenue through the imposition of penalties only as an ancillary means to the fair administration of its taxing provisions.

As a final point, the decision of the United States to cap the FATCA penalty for failure to remit for a particular tax year at $50,000 is interesting. This amount, it is asserted, is just low enough to potentially deter individual challenges, owing to the legal costs that would be incurred in mounting a judicial review application. In this regard, it is important to note that section 18.4(2) of the Federal Courts Act provides that "[t]he Federal Court may, if it considers it appropriate, direct that an application for judicial review be treated and proceeded with as an action." The old rule 299.11 provided a means of converting an application for judicial review to a class action via section 18.4(2). This rule (along with rules 299.1 to 299.42) was repealed effective December 13, 2007[159] and replaced with Class Proceeding Rules 334.1 to 334.4. The new rules make no specific mention of a such a conversion; however, it is clear that an application for judicial review can be converted to an action and presumably, the jurisdiction remains to certify a class proceeding for a converted judicial review application under the new rules.

CONCLUSIONS

Despite the increasing trend toward judicial comity, the revenue rule and the penal/public-law rule are still the law of the land. With respect to the enforcement of FBAR fines and penalties, since the BSA is not a taxing statute, the revenue rule would not apply, and ultimately any application or action brought by the United States for FBAR enforcement in a Canadian court would be barred by operation of the penal rule. A similar action brought for enforcement of FATCA claims would be barred by both rules.

This leaves the matter of the impact of the assistance-in-collection provisions of the Canada-US tax treaty. Again, since the BSA is not a taxing statute, FBAR collection claims would not fall under the provisions of the treaty. The issue of FATCA individual reporting claims is more problematic. In the event that the United States were to make an application for enforcement of fines for failure to file FATCA returns, the minister would have the discretion to reject or accept such applications. However, the statutory interpretation of paragraph 1 of article XXVI A may alone be determinative of the issue, thereby obviating the need for the exercise of that discretion—an

159 *Canada (Citizenship and Immigration) v. Hinton*, 2008 FCA 215.

outcome that would, no doubt, be welcomed by the minister so as to avoid a reciprocity war. However, the existence of that discretion could still be used as a negotiating tool as Canada seeks some compromise with the United States on the FATCA FFI requirements.

In my view, paragraph 1 of article XXVI A should be interpreted such that no claims consisting of only a punitive component could properly form the subject matter of a revenue claim. This interpretation is consistent with the OECD interpretation which requires an underlying tax claim to form a part of the revenue claim. This interpretation is also more in keeping with good tax policy than an interpretation that would allow stand-alone claims for penalties.

If the recommended interpretation were not accepted by the minister, and the minister were to proceed with assistance in collection of FATCA claims, Charter considerations would apply to the collection mechanism of the CRA, and it would be open to any aggrieved taxpayer (alone or perhaps as part of a class action) to assert that public policy should preclude cooperation with enforcement on two grounds: (1) that the FATCA FFI disclosure requirements (which would form the basis for a FATCA revenue claim) would not be constitutional in Canada; and (2) that "but for" the information obtained by FATCA FFI disclosures, the United States would in most cases have no basis to impose FATCA fines in the first place. The case law does indicate that the constitutionality of a foreign law can be examined where the issue of constitutionality is incidental to the litigation. However, as is also noted in this article, the threshold for refusing a foreign claim on the basis of public policy alone, at least in the context of private international law, is a very high one indeed.

One thing does seems clear, and that is the fact that because of the existence of article XXVI A, paragraph 8, no dual US-Canadian citizens resident in Canada can be subject to enforcement of either the FBAR or the FATCA regime insofar as their Canadian assets are concerned. The presence of that paragraph may well compel a number of individuals resident in Canada to seek Canadian citizenship as a means of avoiding potential US claims under the treaty.

Finally, although the revenue rule and the penal/public-law rule would currently preclude Canadian courts from assisting in collection, the ever-expanding role of judicial comity may one day see a repeal of these rules, or at least a relaxation of their strictures. Should that occur, the United States would be in a position to resort to principles of public international law as a basis for enforcement, even against dual citizens. In such a case, it may well be open to defendants to argue that the mere fact of their US citizenship should not, in and of itself, be enough to satisfy the real and substantial connection test—especially in cases where the defendant has had little or nothing to do with the United States and has certainly derived no benefit from his or her US citizenship.

APPENDIX 1 FBAR REPORTING REQUIREMENTS[160]

REPORTS OF FOREIGN FINANCIAL ACCOUNTS

(a) *In general*. Each United States person having a financial interest in, or signature or other authority over, a bank, securities, or other financial account in a foreign country shall report such relationship to the Commissioner of Internal Revenue for each year in which such relationship exists and shall provide such information as shall be specified in a reporting form prescribed under 31 U.S.C. 5314 to be filed by such persons. The form prescribed under section 5314 is the Report of Foreign Bank and Financial Accounts (TD–F 90–22.1), or any successor form. *See* paragraphs (g)(1) and (g)(2) of this section for a special rule for persons with a financial interest in 25 or more accounts, or signature or other authority over 25 or more accounts.

(b) *United States person*. For purposes of this section, the term "United States person" means—

(1) A citizen of the United States;

(2) A resident of the United States. A resident of the United States is an individual who is a resident alien under 26 U.S.C. 7701(b) and the regulations thereunder but using the definition of "United States" provided in 31 CFR 1010.100(hhh) rather than the definition of "United States" in 26 CFR 301.7701(b)-1(c)(2)(ii); and

(3) An entity, including but not limited to, a corporation, partnership, trust, or limited liability company created, organized, or formed under the laws of the United States, any State, the District of Columbia, the Territories and Insular Possessions of the United States, or the Indian Tribes.

(c) *Types of reportable accounts*. For purposes of this section—

(1) *Bank account*. The term "bank account" means a savings deposit, demand deposit, checking, or any other account maintained with a person engaged in the business of banking.

(2) *Securities account*. The term "securities account" means an account with a person engaged in the business of buying, selling, holding or trading stock or other securities.

(3) *Other financial account*. The term "other financial account" means—

(i) An account with a person that is in the business of accepting deposits as a financial agency;

(ii) An account that is an insurance or annuity policy with a cash value;

(iii) An account with a person that acts as a broker or dealer for futures or options transactions in any commodity on or subject to the rules of a commodity exchange or association; or

(iv) An account with—

(A) *Mutual fund or similar pooled fund*. A mutual fund or similar pooled fund which issues shares available to the general public that have a regular net asset value determination and regular redemptions; or

(B) *Other investment fund*. [Reserved]

(4) *Exceptions for certain accounts*. (i) An account of a department or agency of the United States, an Indian Tribe, or any State or any political subdivision of a

160 31 CFR 1010.350.

State, or a wholly-owned entity, agency or instrumentality of any of the foregoing is not required to be reported. In addition, reporting is not required with respect to an account of an entity established under the laws of the United States, of an Indian Tribe, of any State, or of any political subdivision of any State, or under an intergovernmental compact between two or more States or Indian Tribes, that exercises governmental authority on behalf of the United States, an Indian Tribe, or any such State or political subdivision. For this purpose, an entity generally exercises governmental authority on behalf of the United States, an Indian Tribe, a State, or a political subdivision only if its authorities include one or more of the powers to tax, to exercise the power of eminent domain, or to exercise police powers with respect to matters within its jurisdiction.

(ii) An account of an international financial institution of which the United States government is a member is not required to be reported.

(iii) An account in an institution known as a "United States military banking facility" (or "United States military finance facility") operated by a United States financial institution designated by the United States Government to serve United States government installations abroad is not required to be reported even though the United States military banking facility is located in a foreign country.

(iv) Correspondent or nostro accounts that are maintained by banks and used solely for bank-to-bank settlements are not required to be reported.

(d) *Foreign country*. A foreign country includes all geographical areas located outside of the United States as defined in 31 CFR 1010.100(hhh).

(e) *Financial interest*. A financial interest in a bank, securities or other financial account in a foreign country means an interest described in this paragraph (e):

(1) *Owner of record or holder of legal title*. A United States person has a financial interest in each bank, securities or other financial account in a foreign country for which he is the owner of record or has legal title whether the account is maintained for his own benefit or for the benefit of others. If an account is maintained in the name of more than one person, each United States person in whose name the account is maintained has a financial interest in that account.

(2) *Other financial interest*. A United States person has a financial interest in each bank, securities or other financial account in a foreign country for which the owner of record or holder of legal title is—

(i) A person acting as an agent, nominee, attorney or in some other capacity on behalf of the United States person with respect to the account;

(ii) A corporation in which the United States person owns directly or indirectly more than 50 percent of the voting power or the total value of the shares, a partnership in which the United States person owns directly or indirectly more than 50 percent of the interest in profits or capital, or any other entity (other than an entity in paragraphs (e)(2)(iii) through (iv) of this section) in which the United States person owns directly or indirectly more than 50 percent of the voting power, total value of the equity interest or assets, or interest in profits;

(iii) A trust, if the United States person is the trust grantor and has an ownership interest in the trust for United States Federal tax purposes. *See* 26 U.S.C. 671-79 and the regulations thereunder to determine if a grantor has an ownership interest in the trust for the year; or

(iv) A trust in which the United States person either has a present beneficial interest in more than 50 percent of the assets or from which such person receives more than 50 percent of the current income.

(3) *Anti-avoidance rule*. A United States person that causes an entity, including but not limited to a corporation, partnership, or trust, to be created for a purpose of evading this section shall have a financial interest in any bank, securities, or other financial account in a foreign country for which the entity is the owner of record or holder of legal title.

(f) *Signature or other authority*—(1) *In general*. Signature or other authority means the authority of an individual (alone or in conjunction with another) to control the disposition of money, funds or other assets held in a financial account by direct communication (whether in writing or otherwise) to the person with whom the financial account is maintained.

(2) *Exceptions*—(i) An officer or employee of a bank that is examined by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, or the National Credit Union Administration need not report that he has signature or other authority over a foreign financial account owned or maintained by the bank if the officer or employee has no financial interest in the account.

(ii) An officer or employee of a financial institution that is registered with and examined by the Securities and Exchange Commission or Commodity Futures Trading Commission need not report that he has signature or other authority over a foreign financial account owned or maintained by such financial institution if the officer or employee has no financial interest in the account.

(iii) An officer or employee of an Authorized Service Provider need not report that he has signature or other authority over a foreign financial account owned or maintained by an investment company that is registered with the Securities and Exchange Commission if the officer or employee has no financial interest in the account. "Authorized Service Provider" means an entity that is registered with and examined by the Securities and Exchange Commission and that provides services to an investment company registered under the Investment Company Act of 1940.

(iv) An officer or employee of an entity with a class of equity securities listed (or American depository receipts listed) on any United States national securities exchange need not report that he has signature or other authority over a foreign financial account of such entity if the officer or employee has no financial interest in the account. An officer or employee of a United States subsidiary of a United States entity with a class of equity securities listed on a United States national securities exchange need not file a report concerning signature or other authority over a foreign financial account of the subsidiary if he has no financial interest in the account and the United States subsidiary is included in a consolidated report of the parent filed under this section.

(v) An officer or employee of an entity that has a class of equity securities registered (or American depository receipts in respect of equity securities registered) under section 12(g) of the Securities Exchange Act need not report that he has signature or other authority over the foreign financial accounts of such entity or if he has no financial interest in the accounts.

(g) *Special rules*—(1) *Financial interest in 25 or more foreign financial accounts*. A United States person having a financial interest in 25 or more foreign financial accounts need only provide the number of financial accounts and certain other basic information on the report, but will be required to provide detailed information concerning each account when so requested by the Secretary or his delegate.

(2) *Signature or other authority over 25 or more foreign financial accounts*. A United States person having signature or other authority over 25 or more foreign financial accounts need only provide the number of financial accounts and certain other basic information on the report, but will be required to provide detailed information concerning each account when so requested by the Secretary or his delegate.

(3) *Consolidated reports*. An entity that is a United States person and which owns directly or indirectly more than a 50 percent interest in one or more other entities required to report under this section will be permitted to file a consolidated report on behalf of itself and such other entities.

(4) *Participants and beneficiaries in certain retirement plans*. Participants and beneficiaries in retirement plans under sections 401(a), 403(a) or 403(b) of the Internal Revenue Code as well as owners and beneficiaries of individual retirement accounts under section 408 of the Internal Revenue Code or Roth IRAs under section 408A of the Internal Revenue Code are not required to file an FBAR with respect to a foreign financial account held by or on behalf of the retirement plan or IRA.

(5) *Certain trust beneficiaries*. A beneficiary of a trust described in paragraph (e)(2)(iv) of this section is not required to report the trust's foreign financial accounts if the trust, trustee of the trust, or agent of the trust is a United States person that files a report under this section disclosing the trust's foreign financial accounts.

APPENDIX 2 FATCA REPORTING REQUIREMENTS FOR FOREIGN FINANCIAL INSTITUTIONS (FFIs)[161]

2. *Procedures for Identification by Participating FFIs of Preexisting Individual Accounts*

Step 3: Private Banking Accounts

(A) The FFI must ensure that all of the FFI's private banking relationship managers:

(i) identify any client of the private banking relationship manager for which the private banking relationship manager has actual knowledge that the client is a U.S. person and request that each such client provide a Form W-9 (Request for Taxpayer Identification Number and Certification);

(ii) perform a diligent review of the paper and electronic account files and other records for each client with respect to whom they serve as a private banking relationship manager, and identify each client (including any associated family members) who, to the best of the knowledge of the private banking relationship manager, has:

(a) U.S. citizenship or lawful permanent resident (green card) status;

(b) a U.S. birthplace;

161 Excerpt from Notice 2011-34, 2011-19 IRB 765.

(c) a U.S. residence address or a U.S. correspondence address (including a U.S. P.O. box);

(d) standing instructions to transfer funds to an account maintained in the United States, or directions regularly received from a U.S. address;

(e) an "in care of" address or a "hold mail" address that is the sole address with respect to the client; or

(f) a power of attorney or signatory authority granted to a person with a U.S. address.

(iii) with respect to each client identified in Step 3(A)(ii):

(a) request documentation to establish whether the client's account is a U.S. account. In particular, the private banking relationship manager must request that each client identified as a U.S. citizen or lawful permanent resident in Step 3(A)(ii)(a) provide a Form W-9. In the case of any client identified as having a U.S. birthplace or address in Step 3(A)(ii)(b) or (c), the private banking relationship manager must request that the client provide either a Form W-9 establishing U.S. status, or a Form W-8BEN (or a substitute certification as may be provided in future guidance) and a non-U.S. passport or other similar government-issued evidence establishing the client's citizenship in a country other than the United States. In addition, to establish non-U.S. status in the case of any client identified as having a U.S. birthplace in Step 3(A)(ii)(b), the private banking relationship manager will be required to obtain from the client a written explanation regarding the client's renunciation of U.S. citizenship or reason that the client did not acquire U.S. citizenship at birth. In the case of any client identified as having standing instructions or directions in Step 3(A)(ii)(d), the private banking relationship manager must request that the client provide a Form W-9 establishing U.S. status, or a Form W-8BEN (or a substitute certification as may be provided in future guidance) and documentary evidence establishing non-U.S. status of the client. In the case of any client identified as having only an "in care of" or "hold mail" address or a power of attorney in Step 3(A)(ii)(e) or (f), the private banking relationship manager must request that the client provide a Form W-9 establishing U.S. status, a Form W-8BEN (or a substitute certification as may be provided in future guidance), or documentary evidence establishing non-U.S. status.

(b) request that any client providing a Form W-9 establishing U.S. status in response to a request under Step 3(A)(iii)(a) also provide a waiver of applicable restrictions, if any, on reporting of the client's information to the IRS.

(iv) treat all accounts associated with a client as U.S. accounts (or, to the extent applicable, as Documented FFIs under Section II.B.3 of Notice 2010-60) if the client is identified as a U.S. person in Step 3(A)(i), or is identified as having U.S. indicia as described in Step 3(A)(ii) and does not establish non-U.S. status as described in Step 3(A)(iii)(a). Notwithstanding the prior sentence, an account held solely by a family member of the client who provides a Form W-8BEN (or a substitute certification establishing non-U.S. status as may be provided in future guidance) and documentary evidence establishing the non-U.S. status of the family member will not be treated as a U.S. account, unless the private banking relationship manager knows or has reason to know the family member is acting as a nominee or agent for the client; and

(v) create and retain lists of all existing clients whose accounts are U.S. accounts, non-U.S. accounts, or recalcitrant accounts.

(B) The FFI must complete the procedures described in Step 3(A) by the end of the first year in which an FFI's FFI Agreement is in effect. If a private banking relationship manager subsequently becomes aware that an account holder of a pre-existing private banking account has any of the U.S. indicia described in Step 3(A)(ii), the private banking relationship manager must request the documentation described in Step 3(A)(iii) from the account holder, and, if the account holder does not establish non-U.S. status pursuant to Step 3(A)(iii) within one year of the date on which the private banking relationship manager discovers the U.S. indicia, include the account in the FFI's reporting of its U.S. accounts or treat the account as a recalcitrant account.

(C) The FFI must ensure that all accounts identified in Step 3(A) for which the account holder has provided a Form W-9 and agreed to waive any applicable restrictions on reporting of their information to the IRS are included in the FFI's reporting of its U.S. accounts. Further, the FFI must ensure that all accounts for which the account holders either have not provided the documentation required in Step 3(A) above or, in the case of U.S. persons, have not agreed to waive any applicable restrictions on reporting of their information to the IRS, are treated as recalcitrant account holders after the end of the first year in which the FFI's FFI Agreement is in effect and are included in the FFI's reporting with respect to such accounts. An FFI's due date for reporting U.S. accounts and information regarding recalcitrant account holders will be the designated reporting dates (to be prescribed) following the close of the first full year covered by the FFI's FFI Agreement.

(D) The FFI must ensure that all of the written requests and responses related to the search are retained by the FFI for ten years.

Step 4: Accounts with U.S. Indicia

(A) From among the accounts that are not identified as U.S. accounts in Step 1, as non-U.S. accounts in Step 2, or as private banking accounts under Step 3, the FFI shall determine whether the electronically searchable information maintained by the FFI and associated with those accounts or account holders (e.g., customer information kept for purposes of maintaining the account, corresponding with the account holder, or complying with regulatory requirements) includes any of the following U.S. indicia:

(i) identification of an account holder as a U.S. resident or U.S. citizen;

(ii) a U.S. place of birth for an account holder;

(iii) a U.S. residence address or a U.S. correspondence address (including a U.S. P.O. box);

(iv) standing instructions to transfer funds to an account maintained in the United States;

(v) an "in care of" address or a "hold mail" address that is the sole address shown in the FFI's electronically searchable information for the account holder; or

(vi) a power of attorney or signatory authority granted to a person with a U.S. address. For this purpose, "electronically searchable information" refers to information that an FFI maintains in its tax reporting files, or customer master files or similar files, that is stored in the form of an electronic database against which standard queries in programming languages, such as Structured Query Language, may be used. Customer master files include an FFI's primary files for maintaining account holder information, such as information used for contacting account holders and for satisfying AML/KYC [anti-money-laundering/"Know Your Customer"] requirements.

Information, data, or files are not electronically searchable merely because they are stored in an image retrieval system (such as .pdf files or scanned documents).

(B) For all accounts identified as containing U.S. indicia described in Step 4(A), the FFI will be required within one year of the effective date of the FFI's FFI Agreement to request certain documentation to establish whether the account is a U.S. account. In particular, if an account holder is identified as a U.S. resident or citizen in Step 4(A)(i), the FFI shall request a Form W-9 from such individual. If the account information includes a U.S. birthplace or address identified in Steps 4(A)(ii) or (iii), the FFI shall request either a Form W-9 establishing U.S. status, or a Form W-8BEN (or a substitute certification as may be provided in future guidance) and a non-U.S. passport or other government-issued evidence of citizenship in a country other than the United States. In addition, to establish non-U.S. status in the case of any account holder identified as having a U.S. birthplace, the account holder will be required to provide a written explanation regarding the account holder's renunciation of U.S. citizenship or reason that the account holder did not acquire U.S. citizenship at birth. In the case of any account identified as having standing instructions in Step 4(A)(iv), the FFI shall request either a Form W-9 establishing U.S. status, or a Form W-8BEN (or a substitute certification as may be provided in future guidance) and documentary evidence establishing non-U.S. status. If the account is identified as containing only an "in care of" or "hold mail" address or a power of attorney described in Steps 4(A)(v) or (vi), the FFI shall request a Form W-9 establishing U.S. status, a Form W-8BEN (or a substitute certification as may be provided in future guidance), or documentary evidence establishing non-U.S. status. Account holders that have not provided appropriate documentation within two years of the effective date of the FFI's FFI Agreement will be classified as recalcitrant account holders from that date until the date on which appropriate documentation is received from the account holder by the participating FFI.

Step 5: Accounts of $500,000 or More

For all preexisting individual accounts that are not identified as U.S. accounts in Step 1, as non-U.S. accounts in Step 2, as private banking accounts in Step 3, or as accounts with U.S. indicia in Step 4, and that had a balance or value of $500,000 or more at the end of the year preceding the effective date of the FFI's FFI Agreement (high value accounts), the FFI must perform a diligent review of the account files associated with the account. To the extent that the account files contain any of the U.S. indicia described in Step 4(A)(i)-(vi), the FFI must obtain the appropriate documentation as indicated in Step 4(B) within two years of the effective date of the FFI's FFI Agreement. Account holders that do not provide appropriate documentation by the required date will be classified as recalcitrant account holders until the date on which appropriate documentation is received from the account holder by the participating FFI.

APPENDIX 3 FATCA INDIVIDUAL REPORTING REQUIREMENTS[162]

INFORMATION WITH RESPECT TO FOREIGN FINANCIAL ASSETS

(a) IN GENERAL.—Any individual who, during any taxable year, holds any interest in a specified foreign financial asset shall attach to such person's return of tax imposed by subtitle A for such taxable year the information described in subsection (c) with respect to each such asset if the aggregate value of all such assets exceeds $50,000 (or such higher dollar amount as the Secretary may prescribe).

(b) SPECIFIED FOREIGN FINANCIAL ASSETS.—For purposes of this section, the term 'specified foreign financial asset' means—

(1) any financial account (as defined in section 1471(d)(2)) maintained by a foreign financial institution (as defined in section 1471(d)(4)), and

(2) any of the following assets which are not held in an account maintained by a financial institution (as defined in section 1471(d)(5))—

(A) any stock or security issued by a person other than a United States person,

(B) any financial instrument or contract held for investment that has an issuer or counterparty which is other than a United States person, and

(C) any interest in a foreign entity (as defined in section 1473).

(c) REQUIRED INFORMATION.—The information described in this subsection with respect to any asset is:

(1) In the case of any account, the name and address of the financial institution in which such account is maintained and the number of such account.

(2) In the case of any stock or security, the name and address of the issuer and such information as is necessary to identify the class or issue of which such stock or security is a part.

(3) In the case of any other instrument, contract, or interest—

(A) such information as is necessary to identify such instrument, contract, or interest, and

(B) the names and addresses of all issuers and counterparties with respect to such instrument, contract, or interest.

(4) The maximum value of the asset during the taxable year.

(d) PENALTY FOR FAILURE TO DISCLOSE.—

(1) IN GENERAL.—If any individual fails to furnish the information described in subsection (c) with respect to any taxable year at the time and in the manner described in subsection (a), such person shall pay a penalty of $10,000.

(2) INCREASE IN PENALTY WHERE FAILURE CONTINUES AFTER NOTIFICATION.—If any failure described in paragraph (1) continues for more than 90 days after the day on which the Secretary mails notice of such failure to the individual, such individual shall pay a penalty (in addition to the penalties under paragraph (1)) of $10,000 for each 30-day period (or fraction thereof) during which

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such failure continues after the expiration of such 90-day period. The penalty imposed under this paragraph with respect to any failure shall not exceed $50,000.

(e) PRESUMPTION THAT VALUE OF SPECIFIED FOREIGN FINANCIAL ASSETS EXCEEDS DOLLAR THRESHOLD.—If—

(1) the Secretary determines that an individual has an interest in one or more specified foreign financial assets, and

(2) such individual does not provide sufficient information to demonstrate the aggregate value of such assets, then the aggregate value of such assets shall be treated as being in excess of $50,000 (or such higher dollar amount as the Secretary prescribes for purposes of subsection (a)) for purposes of assessing the penalties imposed under this section.

(f) APPLICATION TO CERTAIN ENTITIES.—To the extent provided by the Secretary in regulations or other guidance, the provisions of this section shall apply to any domestic entity which is formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets, in the same manner as if such entity were an individual.

(g) REASONABLE CAUSE EXCEPTION.—No penalty shall be imposed by this section on any failure which is shown to be due to reasonable cause and not due to willful neglect. The fact that a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer (or any other person) for disclosing the required information is not reasonable cause.

(h) REGULATIONS.—The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this section, including regulations or other guidance which provide appropriate exceptions from the application of this section in the case of—

(1) classes of assets identified by the Secretary, including any assets with respect to which the Secretary determines that disclosure under this section would be duplicative of other disclosures,

(2) nonresident aliens, and

(3) bona fide residents of any possession of the United States.