Court File No. T-1736-14

FEDERAL COURT

BETWEEN:

VIRGINIA HILLIS and GWENDOLYN LOUISE DEEGAN

Plaintiffs

and

THE ATTORNEY GENERAL OF CANADA AND THE MINISTER OF NATIONAL REVENUE

Defendants

STATEMENT OF DEFENCE

1. The defendants admit the allegations contained in paragraphs 4, 5, 30, 56 - 65, 81, 83, 84, 86, 91, and 97 of the amended statement of claim.

2. The facts alleged in paragraph 1 of the amended statement of claim are admitted only to the extent they summarize the claim advanced by the plaintiffs.

3. The facts alleged in paragraphs 6 - 16 are admitted only to the extent that they are the definitions used by the plaintiffs for the purpose of the amended statement of claim. Some of the terms defined in paragraphs 6 - 16 of the amended statement of claim are defined terms in the *Canada-United States Enhanced Tax Information Exchange Agreement Implementation Act,* S.C. 2014, c. 20, s. 99 (the *"Act*") and ss. 263 – 269 of the *Income Tax Act,* R.S.C. 1985, c. 1, (the "*ITA*", collectively with the *Act* the "Impugned Provisions") or in the *Agreement*

Between the Government of Canada and the Government of the United States of America to Improve International Tax Compliance through Enhanced Exchange of Information under the Convention between Canada and the United States of America with Respect to Taxes on Income and on Capital (the "Agreement"). Where that is the case, the defendants rely on the definition of those terms in the Impugned Provisions and the Agreement.

4. The defendants deny the allegations contained in paragraphs 17 - 29, 31 - 55, 77 - 80, 82, 85, 87 - 90, 92 - 96, 98 and 99 of the amended statement of claim.

5. The defendants have no knowledge of the allegations contained in paragraphs 2, 3 and 66 - 76 of the amended statement of claim.

United States Taxation and Citizenship Law

6. In further response to paragraphs 17 - 24 of the amended statement of claim, the statements in those paragraphs are an oversimplification, and in some cases a misstatement, of U.S. citizenship and taxation law.

7. In further response to paragraphs 17 - 24 of the amended statement of claim, U. S. law is beyond the control of the defendant and none of the Impugned Provisions impose or alter tax or citizenship obligations under U.S. law.

8. In further response to paragraphs 19 and 21 of the amended statement of claim, the *Convention Between Canada and the United States with Respect to Taxes on Income and Capital* (the "*Convention*") addresses, in Article XXIV, the elimination of double taxation.

FATCA

9. On March 18, 2010, the United States passed legislation as part of the *Hiring Incentives to Restore Employment Act* to amend the U.S. *Internal Revenue Code* by inserting sections 1471 - 1474 under chapter 4 of Subtitle A, which are the provisions commonly known as the *Foreign Account Tax Compliance Act* ("*FATCA"*). On July 1, 2014, *FATCA* came into effect.

10. In response to paragraphs 25 - 27 of the amended statement of claim, details of those statements are inaccurate.

11. *FATCA* is not narrowly targeted at identifying the accounts of U.S. citizens in Canada or any other country. *FATCA* provides the U.S. Internal Revenue Service ("IRS") with information for tax compliance purposes about non-U.S. financial accounts held by actual or potential U.S. taxpayers, including U.S. entities, individuals resident in the U.S. (whether citizens or non-citizens and whether or not also resident in another jurisdiction), and U.S. citizens who are resident in jurisdictions other than the United States, including Canada.

12. The United States, under *FATCA,* requires certain financial institutions with operations outside of the United States either to agree to provide specified information about accounts held by U.S. Persons, as defined in the U.S. *Internal Revenue Code* (which includes citizens, residents and certain entities), or to be subject to a 30% withholding tax on certain U.S. source payments made to that financial institution.

13. To avoid the withholding tax, impacted financial institutions must register with the IRS and obtain a Global Intermediary Identification Number from the IRS.

14. Under *FATCA,* the financial institutions must then report information about "United States accounts". The term "United States account" generally means a financial account held by one or more U.S. citizens, residents, U.S. entities or entities in which a U.S. Person owns (directly or indirectly) 10% or more of the votes or value thereof unless those entities are specifically exempted from the definition.

15. *FATCA* raised a number of issues for individuals and entities subject to U.S. taxation and for Canadian financial institutions. Absent the Impugned Provisions, Canadian financial institutions were concerned that they may not have been able to comply with certain aspects of *FATCA* due to domestic legal impediments, including privacy legislation. In the absence of complying with *FATCA,* unless Canadian financial institutions completely isolated themselves from operations and investments in the United States, as well as from *FATCA* compliant

institutions elsewhere, they faced potentially crippling tax and commercial consequences, and payments to their clients would also be subject to withholding.

16. Alternatively, if Canadian financial institutions complied with *FATCA*, clients with U.S. accounts faced the possibility of the 30% withholding tax being applied to certain payments coming into their accounts in certain circumstances. In addition, clients with U.S. accounts could, in certain circumstances, be subject to having their accounts closed.

The Agreement

17. In further response to paragraphs 31 - 50 of the amended statement of claim, many of the details in the description of the Agreement provided in those paragraphs are inaccurate. For example, in many cases the Agreement provides for different rules to apply to accounts held by individuals and accounts held by entities. Many of the statements in paragraphs 31 - 50 of the amended statement of claim apply only in relation to accounts held by individuals.

18. Canada and the United States agreed to the *Convention* in 1980. Article XXVII of the *Convention* authorizes the exchange of information for tax purposes, including on an automatic basis. The exchange of tax information had previously been provided for in the 1942 convention between Canada and the United States and is also provided for in tax treaties between Canada and over ninety other nations.

19. On February 5, 2014, Canada and the United States signed the Agreement. Over one hundred other jurisdictions have entered into similar agreements, or have similar agreements in principle, with the United States to address the impacts of *FATCA* on financial institutions and their clients.

20. The Agreement requires, *inter alia,* that each country provide the other with certain information, and sets out the United States' commitment to further improve transparency and enhance the exchange relationship with Canada by pursuing the adoption of regulations and advocating for and supporting legislation to achieve equivalent levels of reciprocal automatic information exchange.

21. In further response to paragraphs 31 and 55 of the amended statement of claim, Article XXVII of the *Convention* allows for, but does not require, the automatic exchange of information. Under Article 2 of the Agreement, Canada has agreed to the reciprocal and automatic exchange of certain information in respect of Reportable Accounts, as that term is defined in the Agreement.

22. The Agreement sets out a commitment between Canada and the United States to work with partner jurisdictions and the OECD on adapting the terms of the Agreement and other agreements between the United States and partner jurisdictions to a common model for automatic exchange of information, including the development of reporting and due diligence standards for financial institutions. Canada and the United States, as members of the G20, have endorsed and committed to implement the OECD's Common Reporting Standard for

automatic exchange of information, which includes provisions that would result in a common reporting and due diligence standard.

23. The Agreement broadly sets out a framework whereby certain Canadian financial institutions will provide to the Minister of National Revenue (the "Minister") specified information about certain accounts ("U.S. Reportable Accounts") held by individuals or entities that there is reason to believe may be subject to U.S. taxation law. The Minister will in turn forward this information to the IRS.

24. In further answer to paragraph 34 of the amended statement of claim, Canada is not required to exchange information with the IRS until the later of September 30, 2015, or the date on which financial institutions would be required to report to the IRS under U.S. law. Currently, U.S. law grants financial institutions an extension such that they are not required to report to the IRS until June 29, 2015.

25. In further answer to paragraphs 98 and 99 of the amended statement of claim, the impugned provisions implement the Agreement which specifies how to carry out specific exchanges of information provided for under the *Convention*, which is a tax treaty. The provision of information to the IRS occurs under the *Convention* and does not violate s. 241 of the *Income Tax Act.*

26. The Agreement sets out due diligence procedures that, if followed, allow Canadian financial institutions to be treated as complying with their obligations

under *FATCA* (the "Due Diligence Procedures"). These procedures are incorporated in and supplemented by the Impugned Provisions.

27. The Due Diligence Procedures require prescribed financial institutions to undertake prescribed efforts to identify U.S. Reportable Accounts so as to be able to provide certain information to the Minister.

28. In some circumstances, the components of the Due Diligence Procedures vary based on the value of the account, or vary depending on whether the account is held by an individual or an entity.

29. Further, and in specific response to paragraph 47 of the amended statement of claim, under ss. 265(2) and (3) of the *ITA*, financial institutions can choose one of two due diligence procedures for accounts opened by individuals after June 30, 2014. Only one of these procedures requires the obtaining of a self-certification. The other depends on a review of the information provided by the accountholder to the financial institution at account opening.

30. In further response to paragraph 43 of the amended statement of claim, it is not the Agreement but s. 265(5) of the *ITA* which requires Canadian financial institutions to seek certain additional information to follow up on detected information which may indicate that an account holder is a U.S. Person. Under the Agreement, this follow up is optional, but absent it the account is considered a

U.S. Reportable Account. The requirement in the *ITA* for follow up helps to ensure that financial institutions do not report unnecessary information.

31. In further response to paragraph 43 of the amended statement of claim, for several types of the U.S. indicia for which Canadian financial institutions are required to search, the additional information that is required to clarify whether or not the account is a U.S. Reportable Account does not require the accountholder to provide proof of the loss of U.S. citizenship, as the indicia are more typically associated with residence than with citizenship.

32. The Agreement eases the burden of compliance with *FATCA* on individuals, entities and Canadian financial institutions by, *inter alia*:

    a. relieving financial institutions from having to make reports directly to the IRS under *FATCA*, which both removes concerns about compliance with Canadian privacy laws and provides protection to the information under Article XXVII of the *Convention* which permits exchanged information to be used only for tax purposes;

    b. making clear that financial institutions are not required to report on certain classes of accounts, including Registered Retirement Savings Plans, Registered Retirement Income Funds, Registered Pension Plans, Registered Education

Savings Plans, Deferred Profit Sharing Plans, Registered Disability Savings Plans, and Tax-Free Savings Accounts;

c. exempting certain smaller deposit-taking institutions from *FATCA* reporting requirements;

d. exempting certain local financial institutions that are not part of a multi-national group from some reporting requirements;

e. exempting Canadian financial institutions from the provisions of *FATCA* that mandate the closure of client accounts;

f. providing that terms generally should be interpreted according to Canadian law, not U.S. law;

g. providing Canadian rules which are simpler than those set out in *FATCA* and which, to the extent possible, allow financial institutions to rely on existing procedures for compliance with anti-money laundering provisions that financial institutions are already required to undertake;

h. providing that, in relation to compliance with the Impugned Provisions, Canadian financial institutions can utilise their existing relationship with the CRA. This removes the

requirement of having to interface with the IRS in relation to *FATCA*;

i. providing the CRA as an intermediary between Canadian financial institutions and the IRS in relation to complaints of non-compliance; and

j. permanently preventing otherwise compliant Canadian financial institutions that are part of a multinational group from being subject to sanctions for non-compliance by a member of that group that operates in another jurisdiction.

The Impugned Provisions

33. The Impugned Provisions implement the terms of the Agreement. The Agreement and the Impugned Provisions are a response to the passage by the United States of *FATCA*, with the goal of reducing the impact of *FATCA* on Canadian financial institutions and their clients while at the same time facilitating the automatic and reciprocal exchange of financial account information for the purpose of tax administration in order to improve international tax compliance.

34. Broad automatic exchange of information for tax administration purposes has multinational support, including by the G20, the G8, and the OECD, of which organizations Canada is a member. These entities have worked to develop a

Common Reporting Standard, released in July 2014, for the automatic exchange of tax information. The Impugned Provisions have similarities with the Common Reporting Standard for automatic exchanges of tax information.

35. The Common Reporting Standard advances a widely-shared goal among developed countries of maintaining the integrity of their tax systems by making it more difficult for taxpayers to conceal investments through foreign financial institutions, which may allow their income to go untaxed. Automatic exchange of information provides timely information on non-compliance by taxpayers where income has been under-reported.

Interaction of the *Convention* and the Impugned Provisions

36. In further response to paragraph 95 of the amended statement of claim, s. 4(1) of the *Act* provides that in the event of any inconsistency between the provisions of the *Act* or the Agreement and the provisions of any other law (other than Part XVIII of the *Income Tax Act*), the provisions of the *Act* and the Agreement prevail to the extent of the inconsistency. In so far as there is any conflict between the Impugned Provisions and the terms of the *Canada-United States Tax Convention Act, [1984],* which is denied, the *Tax Convention Act* does not necessarily prevail.

37. In further answer to paragraph 96(a) of the amended statement of claim, the exchange of information under Article XXVII of the *Convention*, as specified by

the Act, is not assistance in collection as contemplated under Article XXVIA of the *Convention* and does not engage the provisions of Article XXVIA of the *Convention.* Article XXVIA does not limit the scope of Article XXVII and cannot limit the Act.

38. In further answer to paragraph 96(b) of the amended statement of claim, the information provided under Article XXVII of the *Convention*, as specified by the *Act*, is financial information related to persons who have been identified as being, or potentially being, subject to U.S. taxation law. As a result, the information provided under the Act may be relevant to the assessment of U.S. tax.

39. In further answer to paragraph 96(c) of the amended statement of claim, Article XXV of the *Convention* has no application to the Impugned Provisions. The Impugned Provisions do not impose any taxes. Nor do the Impugned Provisions impose any requirements directly on U.S. citizens. In the alternative, the Impugned Provisions do not impose any greater requirements on U.S. citizens resident in Canada than on Canadian citizens resident in Canada. The Impugned Provisions apply regardless of citizenship and are aimed at individuals who are, or who may be, liable to pay U.S. taxes. Nothing in the Impugned Provisions results in different treatment of U.S. citizens resident in Canada than Canadian citizens resident in Canada who may themselves be liable to pay U.S. taxes.

Constitution Act, 1867

40. In response to paragraph 77 of the amended statement of claim, the defendants deny that the Impugned Provisions, collectively or individually, in pith and substance relate to a matter within the exclusive jurisdiction of the provinces.

41. Rather, and in response to paragraph 78 of the amended statement of claim, the Impugned Provisions are a valid exercise of federal authority under one or more of ss. 91(2), 91(3), 91(15), and 91(16) of the *Constitution Act, 1867*.

42. In response to paragraph 79 of the amended statement of claim, the defendants deny that the doctrine of interjurisdictional immunity applies to render the Impugned Provisions inapplicable to provincially regulated financial institutions, as the Impugned Provisions do not impair legislative authority over a matter at the core of a provincial head of power, as alleged or at all.

43. In response to paragraphs 1(c) and 80 of the amended statement of claim the impugned provisions do not forfeit Canadian sovereignty to a foreign state. The Impugned Provisions simply implement an agreement which provides for the two-way sharing of information between states. The defendants deny that the Impugned Provisions offend unwritten principles of the Constitution, as alleged or at all.

Charter, Section 7

44. In response to paragraph 82 of the amended statement of claim, the defendants deny that the Impugned Provisions expose the plaintiffs to a deprivation of liberty or security of the person.

45. In the alternative, if the Impugned Provisions expose the plaintiffs to any deprivation of liberty or security of the person, which is denied, such deprivation occurs in accordance with the principles of fundamental justice.

46. In further response to paragraph 82 of the amended statement of claim, the Impugned Provisions do not provide for the enforcement of foreign tax debts, but only provide for the sharing of information. Furthermore, the defendants deny that there exists a principle of fundamental justice that foreign tax debts are not enforceable in Canada.

47. In further response to paragraph 82 of the amended statement of claim, the Impugned Provisions are not arbitrary, overly broad, or grossly disproportionate to their intended purpose. Instead, they are carefully tailored to implement the Agreement, to facilitate compliance with existing *FATCA* obligations, and to address issues of international tax compliance.

Charter, Section 8

48. In response to paragraph 84 of the amended statement of claim, the defendants say that any privacy interest in Accountholder Information that may exist is minimal. The plaintiffs, and other U.S. Persons, have pre-existing obligations to provide account information themselves to U.S. taxing authorities and, in addition, the majority of the Accountholder Information was already in the hands of a third party – the financial institution.

49. Any infringement of a reasonable expectation of privacy that may be occasioned by the Impugned Provisions occurs pursuant to lawful authority and is reasonable in the circumstances given that:

    a. Information reported under the Impugned Provisions and provided to the IRS is protected by the provisions of Article XXVII of the *Convention* such that it can be disclosed only to those involved in the assessment, collection, administration or enforcement of taxes covered by the *Convention;*

    b. The Impugned Provisions implement an international agreement that lessens the burden that FATCA would impose on Canadian financial institutions and their clients. The Impugned Provisions are carefully tailored to collect only such information as is required to implement the Agreement and to

provide reciprocal sharing of information to address issues of international tax compliance.

Charter, Section 15

50. In response to paragraphs 87 - 90 of the amended statement of claim, the defendants deny that the Impugned Provisions create a distinction based on grounds enumerated in s. 15 of the *Charter* or analogous thereto, as alleged or at all. Further and in the alternative, if the Impugned Provisions create a distinction based on analogous or enumerated grounds, which is *denied,* the defendants deny that such distinction is discriminatory, as alleged or at all.

Charter, Section 1

51. In the alternative, if the Impugned Provisions infringe ss. 7, 8, or 15 of the *Charter*, which is denied, the Impugned Provisions are constitutional because any such infringement is justified in a free and democratic society.

52. The Impugned Provisions are reasonably necessary to achieve the dual goals of relieving Canadian financial institutions and their clients of the potential for crippling tax and commercial consequences of non-compliance with *FATCA* and furthering Canada's international commitments to share information for the better administration and enforcement of taxation laws.

53. Further, these objectives are of sufficient import to warrant limiting any right which may be infringed and any infringement is proportional to the objectives and to the benefits conferred by the Impugned Provisions.

Response to Relief Sought

54. The defendants oppose the granting of the relief sought in paragraph 1 of the amended statement of claim and seek an order dismissing this proceeding, with costs to the defendants.

DATE: November 10, 2014

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