IIAC ACCVM
Investment Industry Association of Canada Association canadienne du commerce des valeurs mobilières

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Submitted via Email

Attention:

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France Marengère
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Dear Ms. Agarwal and Ms. Marengère:

RE: ADMINISTRATIVE POSITION ON ESTABLISHING PROCEDURES TO DETECT DISTRIBUTIONS TO DISCRETIONARY BENEFICIARIES FOR PURPOSES OF FATCA AND CRS COMPLIANCE

The Investment Industry Association of Canada ("**IIAC**") is the leading national association representing investment firms that provide products and services to Canadian retail and institutional investors. Our members manufacture and distribute a variety of securities including mutual funds and other investment funds. They provide a diverse array of portfolio management, advisory and non-advisory services. Because our members are Canadian financial institutions ("**FIs**"), they generally have obligations pursuant to the following:

- *Part XVIII of the Income Tax Act ("**ITA**")*[1] *and 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 the United States of America and Canada with Respect to Taxes on Income and on Capital ("**IGA**") (collectively referred to as "**FATCA**"); and*
- Part XIX of the ITA ("**CRS**").

[1] RSC 1985, c 1 (5th Supp).

We are writing in regards to the CRA's administrative position that requires an FI to have, in relation to financial accounts of a trust, procedures in place to be notified when a distribution is made to a discretionary beneficiary ("**Discretionary Beneficiary Position**" or "**DBP**"). The DBP is found in the *Guidance on the Canada-U.S. Enhanced Tax Information Exchange Agreement* ("**FATCA Guidance**") at paragraph 9.77 and in the *Guidance on the Common Reporting Standard* ("**CRS Guidance**") at paragraph 9.55. For reference, the relevant portions of the FATCA Guidance and CRS Guidance are reproduced below:

> FATCA Guidance
> **9.77** Where a trust is a passive NFFE, the trust or trustee must disclose all natural persons that are considered controlling persons. Since a discretionary beneficiary of a trust is only considered a controlling person in the calendar year in which they receive a distribution from the trust, the financial institution must have appropriate procedures in place to be notified when a distribution is made to a discretionary beneficiary of the trust in a given year to enable the trust or trustee to disclose such beneficiary as a controlling person. For instance, the financial institution requires a notification from the trust or trustee that a distribution has been made to a discretionary beneficiary within the time needed to correctly comply with their filing requirement each year. This maybe achieve by having:
> - the financial institution seeking annual refreshment of the certification – this requires the trust or trustee to re-certify whether any members of the class of beneficiaries who have received distributions since the previous certification are discretionary; or
> - the financial institution requiring the trust or trustee, as a condition of holding the account and on an as needed and a timely basis, to provide a new certification when the trust has made or will make a distribution to a discretionary beneficiary (this condition can be included in the account opening documents).
>
> CRS Guidance
> **9.55** Where a trust is a passive NFE, the trust or trustee must disclose all natural persons that are considered controlling persons. Since a discretionary beneficiary of a trust is only considered a controlling person in the calendar year in which they receive a distribution from the trust, the financial institution must have appropriate procedures in place to be notified when a distribution is made to a discretionary beneficiary of the trust in a given year to enable the trust or trustee to disclose such beneficiary as a controlling person. For instance, the financial institution requires a notification from the trust or trustee that a distribution has been made to a discretionary beneficiary within the time needed to correctly comply with their filing requirement each year. This maybe achieved by having:
> - the financial institution seeking annual refreshment of the certification – this requires the trust or trustee to re-certify whether any members of the class of beneficiaries who have received distributions since the previous certification are discretionary; or
> - the financial institution requiring the trust or trustee, as a condition of holding the account and on an as needed and a timely basis, to provide a new certification when the trust has made or will make a distribution to a discretionary beneficiary (this condition can be included in the account opening documents).

Requested Relief

On behalf of our members, we respectfully request that the CRA abandon the DBP in the next version of the FATCA Guidance and the CRS Guidance, because the DBP is contrary to law and cannot be justified from a cost versus benefit analysis.

In the alternative, if the CRA disagrees with our request to abandon the DBP in the FATCA Guidance and the CRS Guidance, we respectfully request that the CRA provide a transition period during which penalties will not be applied against FIs that are not yet compliant with the DBP. This is because the DBP represents

a significant operational change for our members, and as a result, our members require sufficient lead-time to implement these changes.

Each of these requests are discussed further below.

Request to Abandon DBP

We respectfully request that the CRA abandon the DBP for two reasons. Firstly, the DBP is contrary to law as it imposes obligations on FIs that are not required by the ITA and IGA. Secondly, the DBP is a significant burden and cost for FIs, which is unlikely to be matched by any increased compliance by trusts in furnishing a new self-certification upon making a distribution to a discretionary beneficiary. Each of these reasons are discussed below.

a) DBP is Contrary to Law

An FI may not rely on a self-certification if it knows, or has reason to know, that the self-certification is incorrect or unreliable. This obligation is in paragraph A of section VI of Annex I to the IGA for FATCA and is in subsection 277(1) of the ITA for CRS. The CRA adopts a similar administrative position in paragraph 9.71 of the FATCA Guidance and in paragraph 9.51 of the CRS Guidance, where it states that "[i]f there is a change in circumstances that causes the financial institution to know, or have reason to know, that the self-certification or other documentation associated with the account is incorrect or unreliable, the financial institution must request a self-certification or other documentation from the account holder".

Based on the foregoing, FIs are only obligated to obtain a new self-certification if they know, or have reason to know, that the original self-certification is incorrect or unreliable. However, neither the ITA nor the IGA impose a positive obligation on the FI to conduct an inquiry on whether a change in circumstance occurred for purposes of determining whether a new self-certification is required. The CRA appears to agree with this view, as paragraph 8.28 of the FATCA Guidance and paragraph 8.18 of the CRS Guidance state that an FI "can rely on a self-certification without having to enquire into possible changes of circumstances that can affect the validity of the statement, unless it knows or has reason to know that circumstances have changed". For example, if an account holder asks the FI to update their mailing address from Canada to a jurisdiction outside of Canada, there is an obligation for the FI to collect a new self-certification since it knows that the original self-certification is incorrect. However, there is no obligation on the FI to positively confirm with all account holders, each year, whether there has been a change to their mailing address such that a new self-certification is required.

In paragraph 9.76 of the FATCA Guidance and in paragraph 9.54 of the CRS Guidance, the CRA takes the view that a discretionary beneficiary is only considered a controlling person of a trust in the calendar year in which they receive a distribution. Accordingly, we agree with the CRA's position in paragraph 9.70 of the FATCA Guidance and in paragraph 9.50 of the CRS Guidance that a distribution to a discretionary beneficiary is considered a change in circumstance, since the distribution changes the trust's controlling persons (thereby causing the original self-certification, which outlines the trust's controlling persons, to no longer be accurate).

In our view, the DBP is akin to the CRA requiring the FI to conduct an active inquiry on whether a change in circumstance occurred for purposes of determining whether a new self-certification is required. As discussed above, imposing such an obligation is contrary to the due diligence obligation imposed by law.

As stated by the Federal Court of Appeal in *Stemijon Investments Ltd v. Canada*, an administrative policy "is not law" and "it cannot amend the legislator's law".[2]

b) Compliance Costs of DBP to FIs Significantly Outweighs Potential Benefits

It appears to us that the CRA introduced the DBP to address its concerns that trusts may not be providing a new self-certification when their controlling persons change as a result of distributions to discretionary beneficiaries.

Account holders are *already* aware of the requirement to provide a new self-certification upon a change in circumstance, such as when the trust's controlling persons change as a result of a distribution to a discretionary beneficiary. This is because the CRA's self-certification form makes it abundantly clear to the account holder that they must provide a new self-certification within 30 days of a change in circumstance. For example, the certification on the CRA's Form RC519 *Declaration of Tax Residence for Entities – Part XVIII and Part XIX of the Income Tax Act* reads as follows:

Section 4 – Certification

I am an authorized signing officer of this entity and I certify that the information given on this form is correct and complete. I will give the entity's financial institution a new form within 30 days of any change in circumstances that causes the information on this form to become inaccurate or incomplete.

Authorized person's name (print)	Authorized person's signature	Office or position	Date (YYYY-MM-DD)

The DBP imposes additional compliance obligations for FIs by requiring them to confirm whether a change in circumstance occurred. As explained further below, these additional obligations require FIs to spend significantly more time, effort and money. Despite these large costs for FIs, the DBP is unlikely to result in any greater compliance by account holders in furnishing a new self-certification upon a change in circumstance since account holders are already aware of this obligation. Accordingly, the CRA should abandon the DBP because it is not supported by a cost versus benefit analysis.

Alternative Request for a Transition Period for the DBP

In the alternative, if the CRA does not abandon the DBP, we respectfully request that the CRA provide a transition period during which penalties will not be applied against FIs that have not yet complied.

If the CRA does not abandon the DBP, our members will need to significantly change their operational procedures in order to become compliant. This is because the DBP represents a *significant* operational change for our members, and as a result, our members require sufficient lead-time to implement these large changes. For example, the CRA states that FIs may comply with the DBP by requiring, as a condition of holding the account, the account holder to provide a new self-certification when it makes a distribution to a discretionary beneficiary. Our members that wish to implement this approach would need significant lead-time to ensure that (i) the account agreements for any newly opened accounts are drafted to reflect this condition and (ii) the account agreements for any existing accounts are amended and re-papered to reflect this condition. Similarly, the CRA states that FIs may comply with the DBP by requiring annual refreshment of the self-certification. Our members that wish to implement this approach would need

[2] 2011 FCA 299 at para 60.

sufficient lead-time to redesign their operational procedures to account for the new annual obligation and to educate their account holders on the new annual obligation.

To ensure that our members have sufficient lead-time to properly comply with the DBP, we recommend that a transition period until January 1, 2024 (the "**DBP Commencement Date**") be instituted, during which time the CRA will not assess penalties for non-compliance with the DBP. For example, the CRA may indicate that (i) the DBP will not be effective until the DBP Commencement Date or (ii) the DBP only applies to accounts opened on or after the DBP Commencement Date with no retroactive effect for accounts opened before the DBP Commencement Date.

There is already precedent for our suggested approach – the FATCA Guidance and CRS Guidance state that the "[c]hanges to the administrative procedures applicable to multiple financial institution structures apply from January 1, 2023 and do not require any remediation of existing accounts except when there is a change in circumstances that occurs on or after January 1, 2023" (the "**Multiple FI Transition Period**"). In our view, the Multiple FI Transition Period was required because the asset management industry needed significant time to re-design their operational procedures for accounts held in client-name. Similarly, in order to comply with the DBP, our members require significant time to re-design their operational procedures for trusts with discretionary beneficiaries.

We thank the CRA for considering our comments, and we would be pleased to discuss our practical and technical concerns with you at your convenience.