

U.S. plan to hunt tax cheats picks poor targets abroad

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The long arm of U.S. law is poised to reach deep into the lives of millions of Canadians.

It's called the Foreign Account Tax Compliance Act, or FATCA. Quietly signed into law by President Barack Obama last year, the legislation boasts the lofty goal of dismantling foreign tax havens suspected of looting \$100-billion a year from the U.S. Treasury.

In recent years, the IRS has aggressively pursued a clutch of foreign banks, such as UBS and HSBC, looking for tax cheats.

Now it's preparing a much broader sweep. And foreign banks, brokers, insurers and other financial institutions are crying foul.

Starting in 2013, financial institutions in Canada and around the world must report directly to the Internal Revenue Service all accounts held by U.S. citizens and green card holders, including corporate accounts with significant U.S. ownership, as well as what they own. If they don't comply, the IRS is threatening to slap a punishing 30 per cent withholding tax on any U.S. income, and transactions they or their customers do.

The requirement seems straightforward.

The catch is that Canadian law doesn't require account holders to report their citizenship. In the case of bank accounts, for example, customers need only show a driver's licence and one other piece of identification, verifying residency, but not necessarily citizenship or immigration status. And that's for new accounts. There are no checks on older customers.

The bottom line is that Canadian financial institutions generally don't know the citizenship of their customers. Nor do they have legal grounds for demanding proof - unless Canada changes its own banking and privacy laws.

In a recent letter to Finance Minister Jim Flaherty, **Canadian Bankers Association** President **Terry Campbell** complained that the U.S. law takes an end-run around the Canada Revenue Agency and "attempts to coerce foreign financial institutions into a reporting and withholding relationship with U.S. tax authorities."

The Investment Funds Institute of Canada, which represents mutual funds, is seeking exemptions for RRSPs and other registered plans, as well as accounts worth less than \$500,000. Without those concessions, mutual funds say they would have to regularly comb through millions of accounts looking for evidence of U.S. ownership.

The U.S. law puts Canada's big financial institutions, many of which have vital U.S. subsidiaries, in an awkward spot. Tracking Americans could cost large financial institutions as much as a quarter of a billion dollars apiece, according to an estimate by the European Banking Federation.

Defiance could threaten the health of their U.S. operations.

There are broader principles at stake here for Canadians, including questions of sovereignty, trust and economic efficiency in a globalized world. As one European official complained: "the legislation assumes the world is the United States."

Americans, along with anyone living and paying taxes in the United States, are already required to report their foreign investment and bank accounts to U. S. tax authorities every year. Under U.S. law, Americans are taxed on their worldwide income.

Now, U.S. tax authorities are going a step further, seeking the same information from foreign financial institutions. That, presumably, would allow the IRS to match the two reports, spot discrepancies and grab any taxes owing.

But the law also assumes that Canada is a tax haven until proven otherwise, rather than the other way around.

Canadian banks argue there's a much more sensible way to get at the problem. The Canada Revenue Agency and the IRS already have extensive information sharing arrangements, governed by an elaborate tax treaty. That ensures that each jurisdiction gets its fair share of income taxes, while avoiding double taxation.

Canadian financial institutions already report income paid to non-residents, remitting withholding tax to the CRA.

And if U.S. authorities have suspicions about certain accounts or individuals, they can approach the CRA on a case-by-case basis. The two countries also co-operate on combatting money laundering.

In the end, it may prove a lot simpler for Canadian financial institutions to simply close existing accounts with links to Americans, and force prospective U.S. customers to jump through hoops to open new ones.

That would be unfortunate. Banking relationships are the grease that makes the global economy work. Make that process too restrictive, and the United States could inadvertently stifle a lot of legitimate trade and foreign investment flows.

It's similar to the post-9/11 border restrictions, which, while aimed at combating terrorism, have sideswiped trade. Tougher U.S. visa rules have similarly hurt U.S. tourism, along with the kinds of academic exchanges that drive innovation.

By all means, pursue tax cheats. Just beware of the unintended consequences.

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