The Common Reporting Standard Comes to Canada

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Although CRS and FATCA are strikingly similar, tax professionals should be aware of the significant differences.

Legislative proposals relating to implementation of the Organisation for Economic Co-operation and Development (OECD) common reporting standard were announced by the Minister of Finance for Canada in April 2016. However, those proposals codified as part XIX of the Income Tax Act (ITA) were not effective until 7/1/17. Part XIX of the ITA is supplemented by Guidance on the Common Reporting Standard (the Guidance) released by the Canada Revenue Agency (CRA) on 3/22/17. While Canada is only one of 101 countries that have adopted the Common Reporting Standard (CRS), its legislation and guidance provide an example of CRS in practice.1

WHO HAS TO REPORT?

CRS reporting is imposed only on "reporting financial institutions."[2] Accordingly, in order for an entity to have CRS reporting obligations, three criteria must be met: (1) the entity must satisfy the definition of a "financial institution"; (2) the financial institution must be regarded as a "Canadian financial institution"; and (3) the Canadian financial institution must satisfy the definition of a "reporting financial institution."[3]

Financial Institutions. Financial institutions are defined as custodial institutions, depository institutions, investment entities, and "specified" insurance companies.[4] Depository institutions are entities accepting "deposits in the ordinary course of a banking or similar business. Entities falling within this definition include entities regulated in Canada as a bank, a trust and loan company, a credit society, a savings

and credit union, or a caisse populaire."[5] The Guidance clarifies that an entity which accepts deposits in order to secure financing provided by the entity or is part of the process of facilitating money transfers is not considered a depository institution.[6] Custodial institutions are defined as entities whose "gross income attributable to the holding of financial assets for the account of others and related financial services equals or exceeds twenty percent of the entity's gross income" for the three most recent years or the duration of the entity's existence if less than three years (the Testing Period).[7] Two types of entities will satisfy the definition of investment entities. First, entities deriving at least 50% of their gross income during the Testing Period from customers for "investing or managing financial assets, providing portfolio management services, or trading in money market and other financial instruments."[8] In addition, entities whose gross income is "primarily attributable to investing, reinvesting or trading in financial assets" if managed by another financial institution are also regarded as investment entities.[9] Examples of investment entities include collective investment vehicles, mutual funds, exchange traded funds, private equity funds, hedge funds, venture capital funds, leveraged buy-out funds, or "any similar investment vehicle established with an investment strategy of investing, reinvesting, or trading financial assets."[10] The Guidance makes clear that entities investing in direct interests in real property such as real estate investment trusts are not considered investment entities.[11] Finally, specified insurance companies are insurance companies issuing cash value insurance or annuity contracts.[12]

Canadian Financial Institution.
In order for an entity satisfying the definition of a financial institution to be regarded as a Canadian financial institution two conditions must be met. First, the financial institution must be "located in" Canada.[13] This means, in the case of a Canadian resident financial institution, only its Canadian branches.[14] Similarly, in the case of a nonresident financial institution, only the branches of that financial institution that are located in Canada are regarded as Canadian financial institutions. In the case of a partnership, the partnership will be deemed to be resident in Canada if control and management of the partnership's business occurs in Canada.[15]

The second requirement for the financial institution to be regarded as a Canadian financial institution is that it must be a "listed financial institution" within the meaning of ITA, section 263(1).[16]These include savings and credit unions, trust companies, loan companies regulated by provincial acts, and other entities authorized under provincial legislation to deal in securities or provide portfolio management or investment advice.

Reporting Financial Institutions.
CRS reporting obligations only apply to reporting financial institutions. Nonreporting financial institutions include the Bank of Canada, most governmental and international organizations, most retirement funds, collective investment vehicles subject to regulation as such and with respect to which all of the interests are held by individuals or entities that are not "reportable persons" (as defined below), certain trusts, and a series of tax-preferenced savings arrangements listed in the Section 9005 regulations (for example, deferred profit sharing plans (DPSPs), pooled registered pension plans (PRSPs), registered retirement savings plans (RRSPs), registered retirement income funds (RRIFs), tax-free savings accounts (TSAs), and registered education savings plans (RESPs)).[17] The ITA describes trusts that are not subject to CRS reporting as those with respect to which the trustee is a reporting financial institution which provides to CRA the information required by CRS "with respect to all reportable accounts of the trust…."[18]

The Guidance makes it clear that "a personal trust used as a means for an individual or a family to hold investable assets" is not regarded as a financial institution.[19] However, trustees of such trust that otherwise satisfy the definition of reporting Canadian financial institutions clearly have CRS reporting obligations. For example, if such a trust is a passive non-financial entity (NFE), the reportable persons with respect to such trust include any "natural persons exercising ultimate effective control over the trust," (including but not limited to settlors, trustees, and trust protectors, and beneficiaries of the trust, including discretionary beneficiaries receiving distributions in the particular calendar year).[20]

The Guidance also confirms that "check-the-box" elections made to the U.S. IRS have no bearing on an entity's status as a reporting financial institution. Thus, the Canadian subsidiary of a U.S. business entity that otherwise satisfies the definition of a financial institution under the ITA

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may be subject to CRS reporting obligations even though that Canadian subsidiary is a "disregarded entity" for U.S. income tax purposes.[21]

The Guidance also makes it clear that entity classifications for purposes of Foreign Account Tax Compliance Act (FATCA) reporting are not relevant for CRS reporting. For example, a charity, religious organization, or other nonprofit entity that satisfies the definition of a financial institution under part XIX of the ITA will be a reporting financial institution for CRS purposes even though it would be excluded from due diligence and reporting obligations under part XVIII of the ITA (the statutory codification of FATCA).[22]

WHO HAS TO BE REPORTED?

Reporting Canadian financial institutions are required to provide CRA with information regarding "reportable jurisdiction persons." These are natural persons and entities deemed resident in countries other than Canada and the U.S. under the tax laws of those jurisdictions and estates of individuals who resided in those countries immediately before death.[23] In the case of an entity that has no residence for tax purposes, the entity will be deemed to reside in the country "in which its place of effective management is situated."[24] Excluded from the definition of reportable persons are publicly traded companies and their related entities, governmental entities, international organizations, any central bank, and financial institutions.[25]

WHAT ACCOUNTS ARE SUBJECT TO REPORTING?

CRS reporting is required with respect to any "reportable account." Unlike FATCA, which has a $50,000 minimum balance as the threshold for reporting, all reportable accounts are subject to CRS reporting regardless of the account balance. Reportable accounts are broadly defined as accounts held by reportable persons (whether individuals or entities) or passive NFEs if "one or more controlling persons of the passive NFE is a reportable person,"[26] but only if the identity of those reportable persons has been revealed through the due diligence procedures required by sections 272-277 of the ITA.[27] In this regard, the ITA does not define the term "account," but does list a series of "excluded accounts" including tax-advantaged retirement or pension accounts with respect to which withdrawals are conditioned on attaining a specified retirement age; various tax advantaged savings accounts with respect to which annual contributions are limited; noncash value life insurance contracts; accounts held solely by estates of deceased individuals with respect to which the account documentation includes the will or death certificate of the decedent; most accounts established by court orders; and credit card accounts with respect to which overpayments cannot exceed $50,000.[28] Also excluded are most accounts associated with tax-advantaged savings arrangements.[29]

Part XIX of the ITA does not define "NFE." The Guidance makes it clear that "NFE" does not have the same meaning as the term "non-financial foreign entity" (NFFE)" as found in the implementing legislation for FATCA (ITA part XVIII) or the intergovernmental agreement between Canada and the U.S., which implements FATCA.[30] The Guidance defines "NFE" as an entity resident in Canada that is not a Canadian financial institution and any entity that is not resident in Canada which is not a financial institution.[31]

In case of accounts held by entities, reporting of the persons deemed to control or benefit from those entities is required only with respect to accounts held by certain passive NFEs. Generally, passive NFEs are distinguished from active NFEs by the character of the income and assets of the NFE. If 50% or

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1 Of the 101 countries committed to adoption of CRS as of June 2017, 50 of those jurisdictions will begin automatic exchanges of information in 2017. Fifty-one of those countries will begin such exchanges in 2018. The U.S. is not one of these countries. With regard to planning opportunities created by the U.S.'s decision to not participate in CRS *see* Ward, "Planning for the Use of the United States as a Financial Haven: Part 1", 45 Tax Mgmt. Int'l J. 677 (11/11/16) and "Planning for the Use of the United States as a Financial Haven: Part 2", 45 Tax Mgmt. Int'l J. 749 (12/9/16).

2 ITA, section 270(1), definition of "Canadian financial institution."

3 Guidance, section 3.2.

4 ITA, section 270(1), definition of "financial institution." Guidance, section 3.3.

5 ITA, section 270(1), definition of "depository institution." Guidance, section 3.5.

6 Guidance, sections 3.6 and 3.8.

7 ITA, section 270(1), definition of "custodial institution." Guidance, section 3.9.

8 Guidance, sections 3.14 and 3.15. See also ITA 270(1), definition of "investment entity."

9 ITA, section 270(1), definition of "investment entity" (b). Guidance, section 3.16.

10 Guidance, section 3.21.

11 See Guidance, section 3.22.

12 ITA, section 270(1), definition of "specified insurance company." Guidance, section 3.23.

13 ITA, section 270(1), definition of "Canadian financial institution" (a). Guidance, sections 3.30, 3.31.

14 While the definition of "reportable jurisdiction person" in section 270(1) of the ITA makes clear the reporting is determined by the tax residence of the account holder or its controlling persons, neither the ITA nor the Guidance define when a financial institution is "resident in Canada."

15 Guidance section 3.32.

16 ITA, section 270(1), definition of "Canadian financial institution" (b). See Guidance, section 3.34.

17 ITA, section 270(1), definition of "non-reporting financial institution." Guidance, sections 3.34, 3.47.

18 ITA, section 270(1), definition of "non-reporting financial institution" (e).

19 See Guidance, section 3.36.

20 ITA, section 270(1) definition of "controlling person." Guidance, section 6.48.

21 Guidance, section 3.38.

22 Guidance, section 3.48.

23 ITA, section 270(1), definition of "reportable jurisdiction person." While the definition of "reportable jurisdiction" excludes only Canada and the U.S., countries not participating in CRS, a fortiori, would also appear excluded.

24 ITA, section 270(1), definition of "reportable jurisdiction person."

25 ITA, section 270(1), definition of "reportable person."

26 ITA, section 270(1), definition of "reportable account"(a)(ii).

27 ITA, section 270(1), definition of "reportable account" (b).

28 ITA, section 270(1), definition of "excluded account." Guidance, section 6.17.

29 See ITA, section 270(1), definition of "excluded accounts" (g); Guidance, section 6.21.

30 See Guidance, section 4.2

31 *Id.*

more of the NFE's gross income during the preceding fiscal period is passive income and 50% or more of the assets held by the NFE during that period are assets that produce or are held for the production of passive income, the entity is a passive NFE unless:

- The stock of the NFE is regularly traded on an established securities market or the NFE is related to an entity whose shares are regularly traded on an established securities market.
- The NFE is a governmental entity, an international organization, a central bank, or wholly owned entity of one or more such entities or organizations.
- The NFE is a holding company for entities engaged in the active conduct of a trade or business, unless the NFE functions as an investment fund (such as a private equity fund, venture fund, or other investment vehicle organized to acquire equity interests in other businesses for investment purposes).
- The NFE is newly organized such that it has been in existence for 24 months or less with the intent to operate a business that would not satisfy the definition of a financial institution.
- The NFE was not a financial institution in the last five years and is either in the process of liquidating or reorganizing to conduct a business other than that of a financial institution.
- The entity operates as a treasury center for related companies.
- The entity is a tax exempt organization, organized for exempt purposes with no equity owners to whom its assets may be distributed that are not governmental entities or other nonprofit organizations.[32]

Passive NFEs also include professionally managed investment entities resident in non-CRS jurisdictions.[33] The Guidance notes that "passive income" is not defined in part XIX of the ITA and provides that it is to be interpreted consistently with the OECD commentaries on CRS.[34] As such, examples of passive income include dividends, interest and interest equivalents, rents and royalties (other than those derived in the active conduct of a trade or business operated, at least in part, by employees of the NFE), annuities, net gains from sales or exchanges of assets producing the preceding types of income, net gains derived in financial asset transactions such as futures, forwards, and options contracts, net foreign currency gains, net income from swaps, and amounts paid by cash value insurance contracts.[35]

Reportable accounts are limited to accounts that satisfy the definition of financial accounts.[36] Financial accounts are defined as depository accounts, custodial accounts, equity or debt interests in investment entities, insurance contracts with cash value, annuity contracts, and brokerage accounts.[37] In addition, financial accounts also include equity or debt interests in financial institutions "if one of the purposes of establishing the class of interests was to avoid" CRS reporting.[38] Depository accounts include the customary array of accounts offered by banking institutions as well as guaranteed investment contracts and similar arrangements offered by insurance companies.[39] Custodial accounts are accounts held for the benefit of another person.[40]

In order for an account to be a reportable account it must also be "maintained" by a financial institution.[41] This concept is intended to determine who has the reporting obligation, for example in a case in which an agent satisfying the definition of a financial institution performs administrative functions in connection with an account held at another financial institution.[42] The common feature in the examples provided by the Guidance is that the financial institution maintaining the financial account is the one that is obligated to make payment to the actual or beneficial owner of the account. Consistently, the Guidance carves out an exception for equity or debt interests in investment entities if the services of the investment entity relate to accounts deposited in the name of the investor with another financial institution.[43] In the case of a trustee that is a financial institution but holds trust assets in the custody of other financial institutions, CRS subjects those other financial institutions to its due diligence and reporting requirements instead of the trustee.

WHAT INFORMATION IS REPORTED?

Canadian financial institutions are required to provide CRA with the name, addresses, country of residence, tax identification number (TIN), and place of birth for each reportable person that is an account holder for each of

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32 Guidance, section 4.5.
33 ITA, section 270(1), definition of "passive NFE" (b). Guidance, section 4.4.
34 *See* Guidance, section 4.8.
35 Guidance, section 4.8.
36 Guidance, section 6.1.
37 ITA, section 270(1), definition of "financial account" (a). Guidance, section 6.2.
38 ITA, section 270(1), definition of "financial account" (a)(iv).
39 ITA, section 270(1), definition of "depository account." Guidance, sections 6.30-.33.
40 ITA, section 270(1), definition of "custodial account." Guidance, sections 6.34-.36.
41 Guidance, section 6.4.
42 See Guidance, section 6.6.
43 See Guidance, section 6.10.
44 ITA, section 271(1)(a). Guidance, section 12.4.
45 ITA, section 270(1), definition of "account holder" (a).
46 *Id* (b).
47 ITA, section 271(1)(b). While the statute makes no distinction between passive and active entities, the Guidance limits reporting regarding controlling persons to the controlling persons of passive NFEs. See Guidance, sections 10.1 and 12.5.
48 ITA, section 270(1), definition of "TIN."
49 ITA, section 271(1)(c)-(g).
50 ITA, section 271(3)(a).
51 ITA, section 271(3)(b).
52 ITA, section 272(1).
53 ITA, section 273(2)(a). Guidance, section 8.15. An in-care-of address or post office box is insufficient. Guidance, section 8.10.
54 See Guidance, sections 8.21, 8.22.
55 ITA, section 272(3)(b). Guidance, section 8.24.
56 ITA, section 273(2)(c).
57 ITA, section 273(2)(f)(i). Guidance, section 8.25.

the financial institution's reportable accounts.[44]

Account holders are identified as the persons listed or identified as holding the account in the records maintained by the financial institution (other than a person holding the financial account on behalf of another person as an "agent, custodian, nominee, signatory, investment advisor or intermediary").[45] In the case of a life insurance or annuity contract, the account holder is the person entitled to the cash value of the contract or the person with the authority to change the beneficiary of the contract. If no one can access the cash value or change the beneficiary, the account holder is the person identified as the owner of the insurance or annuity contract and any person entitled to receive payment under the contract.[46]

In the case of entities, the same information must be reported regarding each of the controlling persons of the entity, as well as the name, address, country of residence, and TIN of the entity.[47] For this purpose, the TIN of the reportable persons includes both the identification number assigned to the reportable person by Canada as well as the country of that person's tax residence.[48] In addition, the financial institution must provide the account number, name, and identifying number of the reporting financial institution, the account balance or value at the end of the calendar year for which reporting is required, and the gross amount of revenue realized with respect to the account (interest, dividends, and other income) and the gross proceeds realized from sale or redemption of assets held in the account or redemption of the account itself.[49] In the case of preexisting accounts (that is accounts established prior to 7/1/17), the TIN or date of birth are not required to be reported if not in the records maintained by the financial institution and not otherwise required to be collected under the ITA.[50] However, the reporting financial institution is required to use reasonable efforts to obtain the TIN and date of birth by the end of the second calendar year following the year in which the preexisting account becomes a reportable account.[51] Preexisting accounts do not become reportable accounts until they are identified as such pursuant to the due diligence procedures in sections 272 through 277 of the ITA.[52]

The reporting requirements notwithstanding, in addition to the exemptions provided with respect to excluded accounts described above,

The TIN of the reportable persons includes both the identification number assigned to the reportable person by Canada as well as the country of that person's tax residence.

financial institutions are excused from due diligence with respect to many preexisting accounts. In the case of accounts with balances of less than $1 million as of the close of the calendar year with respect to which reporting is made (lower value accounts) the reporting financial institution may treat the account as being owned by a resident of Canada (and therefore not subject to reporting) if the financial institution's records reflect the account holder has a residence in Canada and the information is based on documents provided to the institution.[53] Documentary evidence that is sufficient for purposes of establishing the account holder's residence is set forth in section 8.21 of the Guidance.[54]

Absent an address supported by the appropriate documents in the reporting financial institution's records, the reporting financial institution is required to review electronically searchable data for any of the following indicia:

- Identification of the account holder as a resident of a reportable jurisdiction.
- Current mailing or residence addresses in a reportable jurisdiction.
- Any telephone numbers in a reportable jurisdiction.
- Standing fund transfer instructions to an account in a reportable jurisdiction.
- A currently effective power of attorney or signatory authority granted to a person with an address in a reportable jurisdiction.
- Hold mail instructions or an in-care-of address in a reportable jurisdiction.[55]

If none of the foregoing indicia exist or are discovered in the electronic search, the reporting financial institution is not obligated to engage in any further review until one of those circumstances arises or the account balance at the end of the year exceeds $1 million (a high value account).[56] In contrast, if the account holder provides self-certification that the account holder resides in either Canada or the U.S. supported by appropriate documentation the financial institution is not required to treat the account holder as a resident of a reportable jurisdiction, notwithstanding indicia of current mailing or residence addresses in a reportable jurisdiction, one or more telephone numbers in a reportable jurisdiction, or standing instructions to transfer funds to an account maintained in a reportable jurisdiction.[57] Further, if the reporting financial institution receives self-certification that the account holder is not a resident of the reportable jurisdictions revealed by the financial institution's electronic search of its database or provides documentary evidence "establishing the account holder's non-reportable status in relation to that jurisdiction," the reporting financial institution may disregard a currently effective power of

attorney or signatory authority granted to a person with an address in the reportable jurisdiction.[58] The Guidance makes it clear that self-certifications cannot be relied on if the financial institution knows or has reason to know that the self-certification is incorrect or unreliable.[59] "In assessing whether reliance can be placed on a self-certification, a financial institution must consider other information that it has obtained concerning the account holder in connection with the account opening, including any documentation obtained for purposes of the AML/KYC procedures and any information that an account holder voluntarily provides to it."[60]

Enhanced due diligence is required with respect to preexisting high value accounts. Electronic databases must be searched to identify the account holder's country of residence, the account holder's residence and mailing addresses, telephone numbers, fund transfer instructions, hold mail instructions, in-care-of addresses, and powers of attorney or signatory authority for the account.[61] If this information is not revealed through an electronic search of the reporting financial institution's database regarding its account holders, a paper search must be undertaken of the financial institution's "current customer master file" and additional documents obtained by the reporting financial institution within the prior five years including documents collected with respect to the account, the most recent account opening documentation, the most recent AML/KYC documentation, any power of attorney or signature authority forms, and any standing instructions regarding fund transfers.[62] In addition, if the account was assigned to a relationship manager, the financial institution must inquire whether the relationship manager has actual knowledge that the account holder is a reportable person.[63] In the case of any low value account which subsequently becomes a high value account (determined on the last day of the calendar year), the enhanced due diligence procedures must be undertaken in the next calendar year.[64] Once the enhanced due diligence procedures have been undertaken by the financial institution, it is not required to undertake that due diligence again, other than making annual inquiry of the relationship manager.[65] However, if the reporting financial institution is unable to obtain the information required to be reported from the account holder, it must treat the account as an undocumented account and perform the enhanced due diligence applicable to high value accounts annually.[66]

In the case of preexisting individual accounts, reporting financial institutions are required to review the account information before 2020 in the case of lower value accounts and before 2019 in the case of high value accounts.[67] Once a preexisting reportable account is identified as a reportable account it is treated as a reportable account for all subsequent years unless the account holder ceases to be a reportable person.[68]

In the case of preexisting entity accounts, reporting financial institutions are not required to undertake any due diligence nor report any information available with regard to those accounts unless the account balance was in excess of $250,000 on 6/30/17 or reaches that threshold on the last day of any subsequent calendar year.[69] In the case of accounts that exceed $250,000 on the last day of a subsequent calendar year, the due diligence must be completed by December 31 of the following year.[70] In the case of preexisting entity accounts that exceed $250,000 on 6/30/17, the due diligence procedures must be undertaken and completed on or before 12/31/19.[71] In contrast, due diligence regarding new accounts is expected be undertaken when the account is opened or "as soon as possible thereafter."[72]

The due diligence and reporting requirements applicable to preexisting entity accounts only apply to accounts held by entities that are reportable persons or passive NFEs with one or more controlling persons who are reportable persons.[73] The Guidance makes clear that the account is a reportable account even if the entity that holds the account is not a reportable person if that entity is a passive NFE with one or more controlling persons who are reportable persons.[74] With regard to preexisting entity accounts that are subject to CRS reporting, the reporting financial institution must review the information it maintains for regulatory or customer relationship purposes (including information obtained as part of its AML/KYC procedures) to determine if the account holder is resident in a reportable ju-

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58 ITA, section 273(2)(f)(ii). Guidance, section 8.32. Self-certification is provided by Form RC520 for individuals and Form RC521 for entities.
59 See Guidance, section 7.23. See also ITA, section 277(1).
60 Guidance, section 7.24.
61 ITA, section 273(3)(a). Guidance, section 8.37
62 ITA, section 273(3)(b). Guidance, section 8.38.
63 ITA, section 273(3)(d).
64 ITA, section 273(3)(f).
65 ITA, section 273(3)(g).
66 *Id.*
67 ITA, section 273(4).
68 ITA, section 273(5).
69 ITA, section 275(1). Guidance, section 10.5.
70 Guidance, section 10.34.
71 Guidance, section 10.34
72 Guidance, section 10.36.
73 ITA, section 275(3). Guidance, sections 10.8, 10.9.
74 See Guidance, section 10.99.
75 ITA, section 275(4)(a). Guidance, section 10.11.
76 ITA, section 275(4)(a). Guidance, sections 10.13, 10.14.
77 ITA, section 275(4)(b). See Guidance, section 10.15.
78 ITA, section 275(4)(b)(i). Guidance, section 10.15.
79 ITA, section 275(4)(b)(iii). Guidance, section 10.19.
80 ITA, section 275(5).
81 ITA, section 274(1).
82 *Id.*
83 See ITA, section 276(a). Guidance, section 10.26.
84 ITA, section 276(a)(1). Guidance, section 10.26.
85 See Guidance, section 10.25.
86 ITA, section 276(b). Guidance, section 10.30.
87 ITA, section 276(b)(i). See Guidance, section 10.28.
88 ITA, section 276. Guidance, section 10.30.
89 ITA, section 276(b)(ii).
90 See Guidance, section 10.31.
91 ITA, section 276(b)(iii). Guidance, section 10.31.
92 Guidance, section 10.32.
93 Guidance, section 10.33.

risdiction.[75] Despite such a determination, the account will not be subject to reporting if the account holder provides self-certification that the account holder is not a reportable person or the reporting financial institution "reasonably determines" that the account holder is not a reportable person.[76]

Due diligence is also required with respect to the controlling persons of entities that are passive NFEs. Consequently, in the case of entity accounts, the reporting financial institution must determine whether the account holder is a passive NFE and whether the controlling persons with respect to the passive NFE are reportable persons.[77] This may also be done by obtaining self-certification from the account holder that the account holder is an active NFE or that the entity is a financial institution resident in another CRS participating country.[78] Again the reporting financial institution is authorized to rely on self-certifications from the entity that holds the account or the controlling persons of the entity regarding the residence of the controlling persons or information gleaned through the financial institution's AML/KYC procedures if the account balance does not exceed $1 million.[79] Due diligence for preexisting entity accounts must be undertaken prior to 2020 in the case of accounts with balances in excess of $250,000 on 6/30/17 or by the end of the calendar year following any year in which the aggregate account balance or value exceeds $250,000.[80]

As observed above, although all reportable accounts are subject to CRS reporting regardless of the account balance or value, different due diligence procedures apply depending on the account balance. In the case of new individual accounts, the reporting financial institution is directed to obtain self-certification sufficient to allow the reporting financial institution to determine the account holder's residence for tax purposes.[81] In addition, the financial institution must "confirm the reasonableness of the self-certification" by considering the account information obtained in the process of opening the account, including documentation collected in accordance with the reporting financial institution's AML/KYC procedures.[82]

Similar due diligence procedures are required with respect to the opening of new entity accounts.[83] In the case of new entity accounts, this is a two step process by which the reporting financial institution first determines the residence of the account holder and then determines whether the account is a reportable account. The residence of the account holder is determined by the account holder's self-certification.[84] The reasonableness of the self-certification is determined by reference to the information obtained in connection with opening the account. The Guidance provides that self-certification is not necessary if the entity is a publicly traded corporation or a financial institution based on a review of public information or other information in the financial institution's possession.[85]Determination as to whether the account is a reportable account requires the reporting financial institution to determine whether the entity holding the account is an active NFE or a passive NFE with one or more controlling persons who are reportable persons.[86] The reporting financial institution may rely on self-certification from the account holder to establish its status as a passive or active NFE. However, obtaining such self-certification is unnecessary if the reporting financial institution has information in its possession that confirms that the account holder is an active NFE or a financial institution, certain types of investment entities controlled by other financial institutions, or a financial institution that is not resident in a CRS reporting country.[87] In the case of a passive NFE, the financial institution must determine the identity of the controlling persons of that passive NFE (regardless of whether the NFE is a reportable person).[88] The financial institution may rely on information collected and maintained in accordance with its AML/KYC procedures.[89] The Guidance allows the financial institution to also consult information that is publicly available.[90] Finally, the financial institution must determine whether the controlling persons of the passive NFE are reportable persons but may again rely on self-certification from the account holder or the controlling persons to make this determination.[91] If self-certification is not forthcoming the financial institution must refer to indicia in its own records to determine whether any controlling person is a reportable person.[92] If there is no such indicia in the records of the financial institution it is not required to undertake further due diligence unless such indicia comes to its attention.[93]

Once a preexisting reportable account is identified as a reportable account it is treated as a reportable account for all subsequent years unless the account holder ceases to be a reportable person.

Although cash value insurance policies and annuity contracts are generally regarded as reportable accounts, the life insurance policies and annuity accounts receive deferential treatment under Canada's implementation of CRS. Exceptions from due diligence and reporting are available in the case of beneficiaries of cash value insurance contracts or annuity contracts on receipt of death benefits payable under those arrangements.

Such individual beneficiaries may be presumed to not be reportable persons and the financial accounts that those contracts represent as non-reportable accounts "unless the financial institution has actual knowledge or reason to know that the beneficiary is a reportable person."[94]

For purposes of determining account balance thresholds, aggregation rules apply.[95] Accounts of individuals and entities are required to be aggregated only if the financial institution's computerized systems "link the financial accounts by reference to a data element such as a client number or TIN"[96] and allow the account balances to be aggregated.[97] Accounts subject to aggregation in this manner are those held by the financial institution, as well as its related entities.[98] However, in the case of financial accounts held by an individual, the financial institution will be required to aggregate all financial accounts a relationship manager "knows or has reason to know are directly or indirectly owned, controlled, or established (other than in a fiduciary capacity) by the same individual…."[99]

WHEN IS REPORTING REQUIRED?

Reporting financial institutions are required to provide the information set forth above to CRA on or before 5/2/18 with respect to calendar year 2017 and on May 2 of each year thereafter with respect to reportable accounts for the prior year.[100] The records on which the financial institution has relied to determine the account holder's status must be retained for at least six years after the end of the year the account holder's status was determined. Self-certification must be retained for at least six years following closing of the financial account. All other records must be retained until the end of the last calendar year for which "the record is relevant" (presumably the account remaining open).[101]

Penalties

Reportable persons who fail to provide their TIN are subject to a $500 fine for each such failure unless application for a TIN is made within 90 days of its request by the reporting financial institution and provided to the reporting financial institution within fifteen days after receipt by the account holder.[102] TIN's are not required with respect to those countries which do not provide them.[103]

CRS is not FATCA

CRS and FATCA use confusingly similar terminology and procedures to elicit information subject to disclosure. In many respects CRS has a broader scope than FATCA.[104] FATCA does not require disclosure of accounts with balances of less than $50,000.[105] In contrast, CRS as implemented by Canada has no minimum balance requirement. The FATCA concepts of exempt beneficial owners and deemed compliant financial institutions are not present in Canada's legislation implementing CRS or in the Guidance. "Local Banks" and other institutions excluded by Annex II of the Canada-U.S. IGA are nonetheless subject to CRS reporting obligations.[106] Whatever expectations the governments of CRS participating countries and their bank regulators may have about their financial institutions' cooperation, CRS offers nothing remotely equivalent to FATCA's threat of 30% withholding on U.S. investments without treaty relief. Implementation of FATCA due diligence and reporting is already long-commenced. As observed above, CRS procedures in Canada became effective 7/1/17. Completion of due diligence for preexisting accounts is delayed until 2019 or 2020, depending on account balances.[107]

Under CRS, governments of 101 countries are involved in a multilateral exchange of substantially the same kind of information regarding nonresident accounts. Further, U.S.

NOTES

94 ITA, section 277(2).

95 See ITA, section 277(3).

96 ITA, section 277(3)(a)(i)(A).

97 ITA, section 277(3)(a)(i)(B).

98 ITA, section 277(3)(a)(i).

99 ITA, section 277(3)(b).

100 ITA, section 278(1).

101 ITA, section 278(3). Guidance, section 7.13.

102 ITA, section 281(3).

103 ITA, section 281(3)(b).

104 Section 1471(d)(1)(B); Reg. 1.1471-5(a)(4)(i).

105 Section 1471(d)(1)(B); Reg. 1.1471-5(a)(4)(i).

106 Compare Agreement Between the Government of the United States of America and the Government of Canada 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 (Canada-U.S. IGA), Annex II with ITA, section 270(1), definition of "non-reporting financial institutions" and Guidance, section 3.42. See Canada-U.S. IGA, Annex II, IV; ITA, section 270(1), definition of "non-reporting financial institutions"(f); Guidance, section 3.47.

107 See text at notes 67 to 71, *supra*.

108 A list of countries with which the U.S. has negotiated and signed or reached an agreement in substance can be found at "Foreign Account Tax Compliance Act" *U.S. Department of the Treasury* www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx. Only Model I IGAs have reciprocal information exchange provisions. However, a significant minority of Model I IGAs do not.

109 See Canada-U.S. IGA, Annex II, IV; ITA, section 270(1), definition of "non-reporting financial institutions"(f); Guidance, section 3.47.

110 See note 32, *supra*. Reg. 1.1472-1(c)(1)(iv); ITA, section 270(1), definition of "active NFE" (a).

111 ITA, section 275 (4)(b).

112 Regs. 1.1472(b)(1), 1.1474-(i)(2).

113 See note 20, *supra*.

114 See Section 1473(2)(A)(iii).

115 Sections 1473(3)(A)-(E); ITA, section 270(1), definition of "non-reporting financial institution" (a) through (c).

116 Canada-U.S. IGA, Annex I, VI.B.4(e); Guidance, section 4.5(d).

117 Compare Section 1471(c)(1) with ITA, section 271(1).

118 Compare Reg. 1.1471-4(c)(5)(iv); Canada-U.S. IGA Annex I, II.B.1, D.1 ITA, sections 273(2)(b), (3)(a).

119 See Canada-U.S. IGA, Annex I, IV.D.1(b), VI.A; ITA, sections 273(2)(f)(i)(B), (ii)(B), 277(1).

120 See Canada-U.S. IGA, Annex I, VI.A; ITA, section 273(3)(d).

121 Canada-U.S. IGA Annex I, II.B.2. ITA, section 273(2)(c).

122 Reg. 1.1471-4(c)(5)(iv)(D)(3). ITA, section 273(3)(b).

123 Reg. 1.1471-4(c)(3)(iii). ITA, section 275(1).

124 See ITA, section 275(1).

125 Reg. 1.1471-4(c)(5)(iii)(A).

126 Neither CRS or FATCA permit a financial institution to ignore the real party in interest when it is aware of the use of an agent or nominee to hold title to an account. See Guidance, section 6.55.

127 A limited sense of the Congressional perspective on information disclosures to other countries may be gleaned from the letter of Republican Representative Bill Posey to Jack Lew, Secretary of the Treasury, dated 7/1/13, Tax Analyst DOC2013-16408.

banks are not compelled to collect the same information foreign banks and financial institutions are required to gather regarding their U.S. depositors. Many inter-governmental agreements entered into by the U.S. to implement FATCA impose no due diligence obligations on U.S. financial institutions or reporting obligations on the U.S[108] At best, the IGAs offer only limited information to other countries. The "reciprocal" IGAs do not require the U.S. to give its FATCA partners information about their citizens' or residents':

- U.S. cash accounts held by entities,
- U.S. non-cash accounts held by individuals or entities, or
- The identity of those persons controlling entities with U.S. accounts.

Despite many differences, CRS and FATCA share common features. Generally, the same financial institutions are subject to both regimes. As implemented by Canada, tax-advantaged and other accounts unlikely to be availed by nonresidents are excluded from both regimes.[109] The 50% threshold for passive income and assets discussed above which distinguishes passive from active NFEs for CRS reporting is the same test used to distinguish between passive and active NFFEs for FATCA purposes.[110] In the case of passive NFEs, CRS requires disclosure of their controlling persons.[111] In the case of passive NFFEs, FATCA requires disclosure of their substantial U.S. owners.[112] In the case of a passive NFE which is a trust, CRS requires disclosure of the settlors, trustees, trust protectors, beneficiaries of the trust, and any natural persons exercising effective control over the trust.[113] In the case of NFFEs which are trusts, FATCA requires disclosure of the U.S. persons treated as owners of trust income or corpus under the grantor trust rules of Sections 671-679 and each U.S. person who holds a more than 10% beneficial interest in the trust.[114] Accounts held by publicly traded companies, governmental entities, international organizations, and tax-exempt organizations are generally exempt from reporting under either regime.[115] CRS and FATCA both regard holding companies and treasury centers as active NFEs or NFFEs, respectively.[116] Because of the multilateral character of CRS reporting, gathering and disclosure of an account holder's country of residence and TIN are required. Otherwise the two regimes gather substantially identical information regarding account holders.[117]

The procedures required or allowed to undertake due diligence are substantially the same under FATCA and CRS. Both allow the use of electronic database searching by financial institutions and self-certification by account holders. Similar indicia are relied upon to determine the nonresident status (in the case of CRS) or U.S. status (in the case of FATCA) of account holders.[118] Unless the financial institution knows the self-certification is fraudulent, the indicia suggesting non-resident status may be overcome by self-certification.[119] Relationship managers are expected to be consulted under both regimes.[120] Finally, CRS and FATCA both use a $1 million threshold to distinguish between lower value and high value individual accounts. If indicia requiring reporting are not discovered in the due diligence procedures applied to lower value accounts, no further due diligence is required until the account balance exceeds $1 million.[121] Paper searches must be undertaken if electronic database searches do not reveal the information required to be gathered under both regimes.[122] While FATCA does not require due diligence or reporting for individual accounts with balances below $50,000, both regimes exempt preexisting entity accounts with balances below $250,000 from review or reporting.[123] CRS requires due diligence once the account balance exceeds $250,000.[124] In contrast, preexisting entity accounts with balances below $250,000 are not subject to FATCA due diligence or reporting until the account balance exceeds $1 million. [125]

The reporting financial institution may rely on self-certification from the account holder to establish its status as a passive or active NFE.

AVOIDANCE

CRS and FATCA both suffer from a common weakness. By their nature, both regimes are directed at financial accounts. There is no reporting of a U.S. person's (in the case of FATCA) or nonresident's (in the case of CRS) direct investments in entities engaged in the active conduct of a trade or business or land, collectibles, jewelry, apparel, art, or other tangible assets. Even with regard to accounts, disclosure under both regimes can be avoided by using family members who are not U.S. persons (in the case of FATCA) or tax residents of the CRS reporting country (in the case of CRS).[126]

Perhaps ironically, the U.S. shows no willingness or interest in participating in CRS.[127] For those who wish to avoid CRS reporting and still wish to invest in the many types of financial assets from simple bank accounts to sophisticated financial instruments subject to CRS reporting without the assistance of family members and other nominees willing to own those accounts on behalf of nonresidents, the U.S. is a financial haven. In this regard it should be recognized that the concerns which many individuals have regarding CRS reporting are not motivated by tax avoidance. Many individuals subject to CRS reporting have concerns about the lack of controls to which the account infor-

mation will be subject once disclosed to their home country. Legitimate concerns exist regarding threats of extortion and perhaps kidnapping to which family members living in those countries will be exposed. For those individuals use of the U.S. as a financial haven to avoid CRS reporting should not carry the same opprobrium applicable to tax avoidance.

NON-FATCA DUE DILIGENCE

Despite the lack of or limited reciprocity under its IGAs, the U.S. has recently become more aggressive in gathering information about owners of U.S. domestic entities and foreign ownership of U.S. accounts. Data gathered may, of course, be disclosed to other governments or their tax authorities through formal or informal channels. However, the U.S. is under no obligation to do so.

The Treasury Department in a notice of proposed rulemaking issued on 5/10/16 announced new regulations imposing Section 6038A reporting requirements on domestic disregarded entities wholly owned by a single foreign person.[128] Under those regulations foreign-owned single-member LLCs (FSMLLCs) organized in the U.S. will be treated as corporations.[129] As a result, FSMLLCs will be required to obtain entity identification numbers from the IRS.[130] Doing so will require identification of a natural person related to the FSMLLC. In addition, characterization of an FSMLLC as a corporation will require filing Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business (Under Sections 6038A and 6038C of the Internal Revenue Code), to disclose "reportable transactions" between the LLC and its related parties, including the foreign owner of the FSMLLC and maintaining financial records adequate to confirm the information reported.

FinCEN published rules on 5/11/16 and effective 7/11/16 imposing additional customer due diligence requirements on "covered financial institutions."[131] These include banks, federally insured credit unions, broker dealers, mutual funds, futures commission merchants, and introducing brokers in commodities.[132] The due diligence requirements apply to corporations, limited liability companies, and other entities whose legal existence requires filing public documents with a secretary of state or similar agency and general partnerships and similar entities formed under the laws of non-U.S. jurisdictions (Legal Entity Customers). Covered financial institutions must discern the identity of the "beneficial owners" of Legal Entity Customers whenever new accounts are opened (even if the legal entity customer has a preexisting account with the same covered financial institution). Covered financial institutions are required to obtain personal identifying information regarding each beneficial owner. A beneficial owner is any individual owning 25% or more of the equity interests in the Legal Entity Customer.[133] Beneficial owners also include any single individual with significant responsibility to control, manage, or direct a Legal Entity Customer including executive officers or senior managers or other individuals who regularly perform similar functions.[134]

Just as the U.S. is absent from the list of countries participating in CRS, similarly U.S. domestic trusts are absent from the FinCEN list of Legal Entity Customers subject to FinCEN's customer due diligence requirements to which covered financial institutions are subject.[135] Accordingly, non-U.S. persons are able to deposit assets with U.S. financial institutions without disclosure of their beneficial ownership when the accounts are owned through a U.S. resident trustee. Structuring such a trust requires consideration of the legal and tax issues discussed in the remainder of this article.

SETTLING A U.S. TRUST

Generally if the trust instrument invokes the law of a U.S. jurisdiction

NOTES

128 REG 127199-15. Finalized as TD 9796 (12/13/16), effective for taxable years of entities beginning on or after 1/1/17 and ending on or after 12/13/17.

129 Prop. Reg. 1.301-7701-2(c)(2)(4).

130 Prop. Reg. 28784 (Preamble: Explanation of Provisions).

131 See 81 Fed. Reg. 29398-29458 No. 91 (5/11/16).

132 Reg. 1010.605(e)(1).

133 31 CFR section 1010.230(d).

134 *Id.*

135 81 Fed. Reg. 29398 (Supplementary Information: III) (5/11/16). Trusts (other than business trusts) are not formed by filing organizational documents with the Secretary of State or similar office or require other state action. The executive summary notes that the customer identification program rules to which financial institutions are currently subject requires financial institutions to obtain information regarding persons exerting actual control over accounts which may require the financial institution to gather information about the settlor, trustee, or other persons with the authority to direct the trustee. This due diligence appears not to extend to the identity of the beneficiaries of the trust.

136 See note 20, *supra.*

137 "The term Controlling Persons corresponds to the term 'beneficial owner' as described in the Financial Action Task Force (FATF) Recommendations. For an Entity that is a legal person, the term Controlling Persons means the natural person(s) who exercises control over the Entity, generally natural person(s) with a controlling ownership interest in the Entity." *The CRS Implementation Handbook*, p. 47, para.106. "Countries should require trustees of any express trust governed under their law to obtain and hold adequate, accurate, and current beneficial ownership information regarding the trust. This should include information on the identity of the settlor, the trustee(s), the protector (if any), the beneficiaries or class of beneficiaries, and any other natural person exercising ultimate effective control over the trust." *Financial Action Task Force*: the FATF Recommendations for International Standards on Combatting Money Laundering and the Financing of Terrorism & Proliferation, February 2012 (updated June 2016), p. 91.

138 See generally Section 871(a)(1)(A). In contrast to the income itself, gains from assets which produce U.S. source income are generally not subject to U.S. income taxation when realized by a non-U.S. person (including a non-resident trust). The notable exception, however, are gains derived from sales of U.S. real property interests. See generally Section 897.

139 Section 2102(b). The tax credit of $13,000 yields an exempt amount under the rate schedule of Section 2001(c) of $60,000.

140 Section 2001(c).

141 Sections 2031, 2051.

142 Section 7701(a)(30)(E)(i).

143 Reg. 301.7701-7(c)(3)(v).

144 See Reg. 301.7701-7(c)(4)(ii).

145 Section 7701(a)(30)(E)(ii).

146 Reg. 301.7701-7(d)(1)(ii).

147 Rev. Proc. 2016-45, section 3.01, 2016-45 IRB 707.

(one of the 50 States or the District of Columbia) and the trustee has a legal residence in that jurisdiction, the trust will be viewed as established in the particular U.S. jurisdiction invoked for state law purposes. The most desirable U.S. jurisdictions in which to settle such a trust are those with extended perpetuities periods and no state income tax. To avoid CRS reporting the trust must minimize its contact with non-U.S. jurisdictions, specifically those participating in CRS. None of the trustees should have a presence in any CRS jurisdiction. Further, the trust established in the U.S. must custody its assets exclusively with U.S. financial institutions (or financial institutions in another non-CRS jurisdiction) in order to avoid CRS disclosure. As explained above, financial institutions subject to CRS reporting are required to disclose not only the U.S. trust which owns the account in the CRS jurisdiction but also, "the controlling persons" of that trust.[136] Controlling persons include the settlors, trustees, trust protectors, beneficiaries, and any other natural person exercising ultimate effective control over the trust.[137]

Desirability as a financial haven notwithstanding, the U.S. has a tax system that may be charitably characterized as "challenging." Income taxation of U.S. residents extends to taxation of worldwide income including interest, dividends, rents, annuities, and other categories of investment income, as well as gains realized on sale of foreign and domestic assets.[138] Trusts deemed resident in the U.S. are subject to these revenue laws as much as U.S. citizens and U.S. resident individuals and entities. In addition, in the case of individuals, the U.S. has a comprehensive estate tax system which taxes individuals domiciled in the U.S. on the fair market value of worldwide assets at the time of an individual's death. Absent treaty relief, the U.S. estate tax exemption for nonresidents is only $60,000.[139] U.S. estate taxes are imposed on assets in excess of the exemption amount at rates of 18% to 40%.[140] Unlike the revenue systems of many countries (including Canada) which only subject the decedent's unrealized gains to tax, U.S. estate taxes are imposed on the entire fair market value of the assets included in the decedent's gross estate (reduced only by the decedent's debts and other liabilities to which the assets may be subject).[141]

U.S. INCOME TAXATION

When there is an objective to avoid U.S. income taxation, residence in the U.S. for U.S. income tax purposes should be avoided. If the trust is not deemed to be a U.S. resident for U.S. income tax purposes (a Nonresident Trust), the trust will be subject to U.S. income taxation only on its U.S. source income. Although a trust may be administered under the laws of the U.S. jurisdiction in which the trustee resides, residence for U.S. income tax purposes is determined by an objective test comprised of two elements, both of which must be satisfied in order for the trust to be deemed to be tax resident in the U.S. First, primary supervision over the administration of the trust must be exercised by a court within in the U.S. (the Court Test).[142] "Administration" is defined by Regulations as "carrying out of the duties imposed by the terms of the trust instrument and applicable law, including maintaining the books and records of the trust, filing tax returns, managing and investing the assets of the trust, defending the trust from suits by creditors, and determining the amount and timing of distributions."[143] A safe harbor is provided by the Regulations which confirms a trust will satisfy the Court Test if three conditions are met:

1. The trust instrument does not direct the trust to be administered outside the U.S.
2. The trust is, in fact, administered exclusively in the U.S.
3. The trust is not subject to an automatic migration provision.[144]

Including an automatic migration provision in the trust instrument should cause the trust to fail the Court Test. Consequently, the trust will be deemed nonresident for U.S. income tax purposes.

In addition to satisfaction of the Court Test, one or more U.S. persons must have the authority to control all substantial decisions of the trust in order for the trust to be deemed U.S. resident[145] (the Control Test). Ministerial decisions are insufficient to satisfy the Control Test. Regulations provide the following examples of substantial decisions:

- Whether and when to make distributions of trust income or corpus.
- The amount of a distribution.
- Selection of a beneficiary.
- Whether receipts are properly allocable to income or principal.
- Termination of the trust.
- Compromise, arbitration, or abandonment of claims of the trust.
- Initiating or defending litigation involving the trust.
- Removal, addition, or replacement of a trustee.
- Appointment of successor trustees.
- Investment decisions.

Accordingly, control of any substantial decision by a non-U.S. person (that is, an individual who is not a citizen or resident of the U.S.) will cause the trust to be deemed nonresident for U.S. income tax purposes even though the trustee is subject to jurisdiction of U.S. courts.[146] Trusts that fail either the Court Test or the Control Test will be deemed Nonresident Trusts. Nonresident Trusts are subject to U.S. income taxation only on U.S. source income.

U.S. TAX PLANNING

While trusts have tax brackets with rates that are identical to those of an individual, the amount of income subject to taxation at those rates is considerably less. For example, in 2017 trusts with taxable income in excess of $12,500 will be taxed at the maximum federal income tax rate of 39.6%.[147] In contrast, if the U.S. source income of the Nonresident Trust is taxable to a foreign settlor,

that settlor will get the benefit of not just the rates but also the amounts of the brackets available to individuals. In 2017 the taxable income of an unmarried individual does not become subject to U.S. income taxation at the highest marginal rate of 39.6% until it exceeds $418,400. In order to avoid taxation of income at the higher rates to which trusts are subject, the settlor or a beneficiary must be treated as the owner of the trust for U.S. income tax purposes.

There are only two circumstances in which the foreign settlor of a trust will be treated as the owner of the trust for U.S. income tax purposes and thereby taxable on the income of that trust. First, a foreign settlor will be treated as the owner of the trust when distributions (whether income or corpus) from the trust during the lifetime of the settlor may only be made to the settlor or the settlor's spouse.[148] Second, if the settlor has the power to unilaterally (or with the consent of a related or subordinate party) revest trust property in the settlor, the settlor will be treated as the owner and taxable on the income of the trust.[149] For this purpose, a "related or subordinate party" is defined by Section 672 as any of the following individuals or entities:

- The settlor's spouse if living with the settlor.
- The settlor's father, mother, descendants, or siblings.
- An employee of the settlor.
- A corporation or any individual employed by a corporation in which the equity interest of the settlor and the trust are "significant" for purposes of exercising voting control.
- A subordinate employee of a corporation for which the settlor is an executive.[150]

Even when the circumstances set forth above are present, a settlor will not be treated as the owner of the corpus and income of a trust unless the settlor has made a gratuitous transfer to the trust. In cases in which a trust is settled by a distribution from another trust, the settlor of the trust from which the distribution was made will be treated as the settlor of the recipient trust, unless the person or entity at whose direction the recipient trust was settled (usually the trustee of the trust making the distribution) had powers broad enough to be characterized as a general power of appointment. Section 2041 defines a general power of appointment as a power to appoint assets to oneself, one's creditors, one's estate, or the creditors of one's estate.

If the foreign settlor is treated as the owner of the trust the income and gains of that trust will be taxable to the foreign settlor. If that trust fails to satisfy either the Court Test or the Control Test it will be deemed to be a Nonresident Trust for U.S. income tax purposes even though it is administered under the laws of a U.S. jurisdiction by a U.S. resident trustee. If the trust with respect to which the foreign settlor is treated as the owner is a Nonresident Trust, the foreign settlor treated as its owner for U.S. income tax purposes will only be taxable on U.S. source income. U.S. source income does not include interest paid on bank deposits or interest on portfolio debt obligations.[151]

U.S. ESTATE TAXATION

Just as the foreign settlor who is treated as the owner of a Nonresident Trust will be subject to U.S. income taxation on the U.S. source income of that trust, so may the foreign settlor of a Nonresident Trust be subject to U.S. estate taxation on the assets of that trust. This will occur if the foreign settlor is (1) a beneficiary of the trust and (2) the trust holds assets present or deemed to be present in the U.S.[152] Individuals who are neither citizens nor domiciliaries of the U.S. are nonetheless subject to U.S. estate taxation on tangible assets present in the U.S. (whether real or personal property) and intangible assets deemed to be property within the U.S. (U.S. Situs Assets). Shares of U.S. corporations and debt obligations of U.S. persons (other than portfolio debt obligations) are regarded as U.S. Situs Assets.[153] Even in circumstances in which the settlor is not a beneficiary of the Nonresident Trust, U.S. Situs Assets of that trust will be subject to U.S. estate taxation at the foreign settlor's death if the trust is subject to revocation or amendment by the settlor.[154] Similarly, even if the foreign settlor is not a beneficiary of the Nonresident Trust, U.S. Situs Assets held by that trust will be subject to U.S. estate taxation at the settlor's death if the settlor retains a general power of appointment (as defined above) over the assets of the Nonresident Trust.

OPPORTUNITIES FOR BASIS INCREASES

The basis of trust assets may be adjusted to fair market value at the death of a foreign or domestic settlor in certain circumstances. The assets of the trust need not be subject to U.S. estate taxation at the settlor's death in order to achieve such a basis adjustment.[155] For example, if the income from the trust is payable to the settlor or as the settlor directs, and the settlor reserved the right at all times before death to revoke the trust, the assets of the trust will receive a basis adjustment to fair market value at the settlor's death.[156] Similarly, if the income of the trust was subject to payment during the settlor's lifetime to the settlor or others at the settlor's direction, and the settlor reserved the right at all times

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148 672(f)(2)(A)(ii).

149 672(f)(2)(A)(i).

150 See 672(c).

151 Sections 871(i)(3)(A); 871(h).

152 See Section 2036.

153 Section 2104.

154 Section 2038.

155 Rev. Rul. 84-139, 1984-2 CB 168 (Basis adjustment applies to U.S. Situs Assets as well as non-U.S. Situs Assets). Accord Ltr. Rul. 201245006.

156 Section 1014(b)(2).

157 Section 1014(b)(3).

158 See, e.g. Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital, Article XXIXB(2).

prior to the settlor's death to make any change in the enjoyment of the income through the exercise of power to alter, amend, or terminate the trust, the assets of the trust will be subject to a basis adjustment to fair market value at the settlor's death.[157] In both these circumstances, the U.S. Situs Assets held by the trust will be subject to inclusion in the foreign settlor's gross estate. However, as observed above, the estate of every individual who is neither a citizen nor resident of the U.S. qualifies for an estate tax credit which results in a $60,000 exemption from U.S. estate taxation. Depending on the foreign settlor's residence and the availability of relief provisions in a tax treaty with the foreign jurisdiction in which the settlor resides, additional relief from U.S. estate taxation may be available.[158]

Obviously, careful drafting of the trust instrument is required in order to limit the amount of U.S. Situs Assets held by the Nonresident Trust with respect to which the foreign settlor is treated as the owner to an amount which will not exceed the exemption available to that foreign settlor's estate.

CONCLUSION

While each of the 101 countries participating in CRS may implement the OECD's initiative differently, Canada provides an example of one participating jurisdiction's effort in that regard. While there are substantive differences, much of CRS was drawn from FATCA and reflects many commonalities including the focus of both regimes on accounts with financial institutions to the exclusion of other assets. Both regimes are vulnerable to self-help remedies including account ownership through persons not subject to FATCA or CRS reporting. Fully tax-compliant individuals may be reluctant to disclose personal financial information to their home countries for completely legitimate reasons involving their personal safety and security and that of their family members. These individuals may use the U.S. as a tax-effective financial haven by holding U.S. bank deposits and portfolio debt obligations through a Nonresident Trust administered in a state with favorable trust laws and no state income tax. If properly designed as a Nonresident Trust with respect to which the foreign settlor is treated as the owner for U.S. income tax purposes, non-U.S. source income will be exempt from U.S. income taxation and U.S. source income will be taxable at more favorable U.S. income tax rates than if the income were taxable to the trust. Practitioners need to be cautious that such arrangements do not facilitate foreign tax avoidance, money laundering, or otherwise violate foreign or U.S. domestic laws.

CRS and FATCA use confusingly similar terminology and procedures to elicit information subject to disclosure.