ACPM/ACARR

The Association of Canadian Pension Management

L'Association canadienne des administrateurs de régimes de retraite

April 30, 2012

CC:PA:LPD:PR (REG-121647-10)
Room 5205
Internal Revenue Service
PO Box 7604
Ben Franklin Station, Washington, D.C. 20044

Dear Sir/Madame:

Foreign Account Tax Compliance Act (FATCA)

I am writing to you on behalf of the Association of Canadian Pension Management (**ACPM**) to set out our comments on the proposed regulations relating to information reporting by foreign financial institutions (**FFIs**) and withholding on certain payments to foreign financial institutions and other foreign entities (the **Proposed Regulations**).

We welcome the opportunity to provide written comments on the Proposed Regulations.

In our letter of January 25, 2012, we provided comments on IRS Notice 2010-60, as amended by Notice 2011-34, and the proposed exemptions thereunder for "foreign retirement plans". As we commented then, FATCA has potential significant ramifications for the Canadian retirement income system.

Accordingly, we welcome the steps taken by the Treasury and the IRS in giving greater clarity to the exemptions for foreign retirement plans as set out in the Proposed Regulations. This represents a significant step and addresses many of the concerns set out in our prior letter. Unfortunately, some difficulties remain with the Proposed Regulations and FATCA's impact on the Canadian retirement system. In particular, pension plans sponsored by smaller employers and other retirement savings arrangements may continue to be caught by FATCA.

ACPM

The ACPM is the informed voice of Canadian pension plan sponsors, administrators and their allied service providers. Established in 1976, ACPM advocates for an effective and sustainable Canadian retirement income system. Our members are drawn from all aspects of this industry from one side of this country to the other. They represent over 400 pension plans consisting of more than 3 million plan members, with assets under management in excess of $330 billion.

Impact of FATCA

FATCA creates a new tax information reporting and withholding regime on payments from the US to certain foreign (including Canadian) financial institutions (**FFI**). It appears that under FATCA, Canadian Registered Pension Plans (**RPPs**), as defined in the Canadian *Income Tax Act* (**ITA**), would be categorized as FFIs. In addition, other Canadian funded retirement savings arrangements subject to the ITA would be categorized as FFIs. Such other arrangements include: Registered Retirement Savings Plans (**RRSPs**), Deferred Profit Sharing Plans (**DPSPs**), Registered Income Funds (**RIFs**), Retirement Compensation Arrangements (**RCAs**) and Pooled Registered Retirement Plans (**PRPPs**) (along with RPPs these other funded retirement savings arrangements are collectively referred to in this letter as, **Canadian Retirement Arrangements**).

The FATCA reporting requirements would require the sponsors and/or custodians of Canadian Retirement Arrangements with US holdings to report to US authorities on the beneficiaries of Canadian Retirement Arrangements who are US citizens or taxpayers. A failure to comply with FATCA's reporting requirements could result in any US investments made by or through Canadian Retirement Arrangements being subject to a 30% withholding on all such US investments. Avoiding the application of FATCA by not holding US assets may not be feasible or practical given the integrated nature of the Canadian and US economies.

Meeting FATCA's requirements would present an onerous and costly burden on Canadian pension stakeholders. For example, given the frequent interchange of employees across the Canada-US border, it is not practical or feasible for Canadian sponsors or custodians to simply exclude US citizens from participating in such plans and/or to even do the due diligence required to determine which plan beneficiaries are US citizens. Furthermore, it raises serious questions as to whether sponsors and custodians of Canadian Retirement Arrangements could meet such FATCA reporting requirements while complying with any applicable Canadian privacy and/or fiduciary requirements.

Finally, if a plan's assets do become subject to FATCA's 30% withholding, it is not clear who bears the cost of such withholding. The withholding appears to apply to all US investments of the FFI, not just those that can be attributed to a particular beneficiary – as such, the withholding cost may have to be borne by all plan beneficiaries and/or the plan sponsor through reduced returns on investments.

Exemption Required for Canadian Retirement Arrangements

We believe the all Canadian Retirement Arrangements should be exempt from treatment as FFIs. The Proposed Regulations are a welcome step in that direction and represent a substantial improvement over the proposal set out in Notice 2010-60. However, not all Canadian Retirement Arrangements would appear to be covered under the Proposed Regulations and thereby excluded from the operation of FATCA.

Given the Canadian tax regime under which Canadian Retirement Arrangements operate, the case can be made, using the FATCA terminology, that all such arrangements pose "a low risk of tax evasion", and thus

should rightly fall within the kinds of foreign retirement plans the US Treasury and IRS intend to exclude under the Proposed Regulations.

For example, Canadian Retirement Arrangements are highly regulated by the Canada Revenue Agency (**CRA**) with prescribed limits under the ITA on either (i) the amount that may be contributed by members and/or employers, or (ii) the amount that may be paid as a benefit, which are tied to either the annual income or number of years worked. When amounts are paid out they are fully brought into taxable income of the recipient. Indeed, the limits applicable to Canadian Retirement Arrangements are well below the limits applicable to US based tax-assisted savings arrangements.

Contributions to RCAs are an exception to this rule in that there are no precise limits on benefits or contributions; however, all such amounts contributed to an RCA, along with any earnings thereunder, are subject to a 50% withholding tax to be paid to the CRA – as such they are not an efficient savings vehicle and thus should not be viewed as posing a risk of tax evasion. In addition, all amounts paid out of Canadian Retirement Arrangements are included in taxable income, meaning it would eventually be captured in any tax reporting required by US taxpayer beneficiaries of such arrangements.

Issues with the Proposed Regulations

As noted above, we believe all Canadian Retirement Arrangements should be exempt from the application of FATCA; however, the Proposed Regulations do not appear to provide an exemption for all Canadian Retirement Arrangements. Specifically, smaller RPPs, RRSPs, DPSPs, RIFs and RCAs may not be exempt from FATCA under the Proposed Regulations.

Smaller RPPs

RPPs generally would appear to be exempt from FATCA by virtue of paragraph 1.1471-5(f)(2)(ii)(A)(1). However the requirement that no single beneficiary have a right to more than 5% of the FFI's (ie, the plan's) assets may be problematic for smaller plans and smaller employers.

For example, a defined contribution or money purchase pension plan may have 30 members, but a handful of the plan's membership may have higher earnings and service compared to the plan average – it is quite conceivable that any one of that group may have a right to more than 5% of the plan's assets. However, such individual will have been subject to the same contribution limits under the ITA as the other participants and such person's contributions to the plan would be based on earnings from that employer. We submit that such a plan (with a beneficiary entitled to more than 5% of the assets) does not pose a higher risk of tax evasion, provided the plan meets the other criteria under paragraph 1.1471-5(f)(2)(ii)(A)(1) of the Proposed Regulations. We believe the 5% requirement in this provision should be deleted.

Similarly, we fail to see why separate exemption criteria, as expressed in paragraph 1.1471-5(f)(2)(ii)(A)(2) of the Proposed Regulations, apply in respect of pension plans with less than 20 people. We think paragraph 1.1471-5(f)(2)(ii)(A)(2) should be deleted in its entirety. If a plan meets the criteria set out in paragraph 1.1471-5(f)(2)(ii)(A)(1), subject to our above comments regarding the 5% asset limit, then in our view such a plan poses the same low risk of tax evasion as any other pension plan whether it has one, five or 105 members.

RRSPs/DPSPs

RRSPs may be part of an employer's benefit package or established by individuals through a financial institution separate and apart from their employer. In either situation, all of the contributions are made with the employee's or individual's earnings. In the case of a DPSP, these may only be established by an employer and only employer contributions may be made. Furthermore, contributions may only be made to an RRSP or DPSP if the individual has earned income in Canada. Currently, the aggregate contributions that may be made to RRSPs and DPSPs are capped annually at the lower of 18% of the individual's annual income and CDN$22,970. Individuals may deduct from earned income amounts contributed to an RRSP or DPSP and all contributions may grow tax-free. Generally and depending on the plan terms with the employer, withdrawals may be made at anytime (including before reaching retirement age) and the entire withdrawn amount (contributions plus investment earnings) is brought into taxable income.

But for this last point, RRSPs and DPSPs should fit within the exemption found at paragraph 1.471-5(b)(2)(i)(A)(2) of the Proposed Regulations. However, one of the criteria in this paragraph is that amounts withdrawn prior to retirement age must be subject to a 'penalty'. If the inclusion of the entire withdrawn amount into taxable income constitutes a penalty within the meaning of the Proposed Regulations then RRSPs and DPSPs would fully fit within the criteria expressed at paragraph 1.471-5(b)(2)(i)(A)(2). If not, we would suggest the 'full inclusion into taxable income of all amounts withdrawn' be added as an additional alternative criteria under paragraph 1.471-5(b)(2)(i)(A)(2) of the Proposed Regulations. That is, one of the criteria to be met to qualify for exemption from FATCA under paragraph 1.471-5(b)(2)(i)(A)(2) should be along the following lines: "any amounts withdrawn from such vehicle are included in taxable income in the year in which they are withdrawn or, if amounts are withdrawn prior to retirement age, they be subject to a penalty." We believe the addition of such an alternative criteria would not present any greater risk of tax evasion from a FATCA perspective.

Another concern is the $50,000 limit on contributions. Given the current exchange rates and contribution limits applicable to RRSPs and DPSPs, this would not present a problem at this time. However, the combined RRSP and DPSP contribution limits are linked to inflation and thus rise most years. We would recommend that the $50,000 ceiling under the Proposed Regulation be linked to inflation and that it be reviewed periodically to ensure it remains appropriate given its objectives.

RIFs

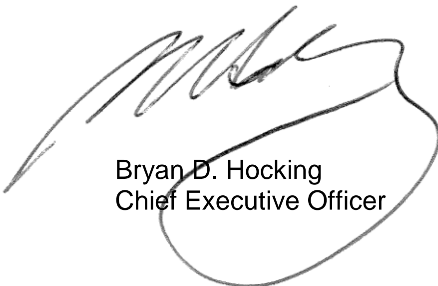
A RIF is a vehicle into which assets held in an RRSP must be transferred by the time the individual reaches age 71 if not otherwise withdrawn from the RRSP. The only contributions that can be made to a RIF are from assets held in an RRSP or DPSP. A RIF continues to allow tax free growth, but minimum annual withdrawals must be made in accordance with a schedule set out under the ITA. All amounts withdrawn are fully taxed. Contributions to a RIF are generally made as a lump sum transfer from an RRSP or DPSP. Given, for example, that the transferring RRSP will likely have accumulated many years' worth of contributions, it is likely that the transfer would be in excess of the $50,000 limit transfer referenced in paragraph 1.471-5(b)(2)(i)(A)(2). This paragraph does provide an exception for such transfers if the transferring account (ie, the RRSP or DPSP) otherwise meets the criteria in paragraph 1.471-5(b)(2)(i)(A)(2). However, as noted above, it is possible that an RRSP may not meet this criteria and thus RIFs that receive transfers in excess of $50,000 may not be exempt from FATCA. Accordingly, we would urge the adoption of the changes suggested above to the Proposed Regulations to address RRSPs/DPSPs or provide clarity as to what constitutes a 'penalty' under the Proposed Regulations.

RCAs are a creature of the ITA. Any time an employer wishes to pre-fund a supplemental pension arrangement (ie, a pension arrangement that provided benefits above the applicable ITA pension benefit limits) it must do so pursuant to an RCA. However, no tax benefit is afforded to an RCA in that all amounts contributed to an RCA, along with any earnings thereunder, are subject to a 50% withholding tax to be paid to the CRA – as such they are not an efficient savings vehicle and thus should not be viewed as posing a risk of tax evasion. The withholding tax is then paid back to the RCA in proportion to payments out of the RCA. All such payments out of the RCA are fully included in taxable income. We suggest that in paragraph 1.471-5(f)(2)(ii)(A)(1) an additional alternate criteria be added along the following lines: "all contributions to and investment income under the FFI are subject to a withholding tax of 50% or more under the laws of such jurisdiction refundable only on payments being made from such FFI."

Further, as RCAs are often established for smaller groups of employees, we would reiterate our comments noted above about removing the 5% of assets criteria and remove completely the rules for benefit plans with less than 20 persons.

We thank you for your time in reviewing our comments. We would be pleased to provide further assistance or explanation as required.

Sincerely,



Bryan D. Hocking
Chief Executive Officer