

## Charities – Part of the Great Underbanked?

By Adam Aptowitzer

Every so often the media reports that there are people in the world who do not have access to banking services, the so-called “underbanked”. For those of us in Canada, it is almost impossible to imagine such a situation, given the ubiquity of our banks and the plethora of services that they offer. However, for registered charities and for Canadian not-for-profits operating overseas this situation is becoming an everyday reality.

Many, if not most, governments (and the Canadian one is no exception), have laws against money laundering and the financing of terrorism. In Canada, various aspects of these laws are found in the criminal code, the Anti – Terrorism Act, and, now, the Income Tax Act (the “ITA”). Obviously, policing every transaction in Canada is a costly endeavour, and so the recent addition of the Common Reporting Standard (“CRS”) to the Income Tax Act downloads the responsibility of monitoring these transactions to banks and other financial institutions.

The CRS was formally known as the Standard for Automatic Exchange of Financial Account Information (little wonder why it was changed). It requires banks to obtain the tax residency of its depositors and, where that residency is foreign, to report the closing bank account balance of any of that depositor’s accounts to the CRA. The CRA then provides that information to the relevant agency of the country of the depositor’s residency (usually the CRA equivalent).

For organizations like charities the banks will take note of the directors’ residencies, and where the donor is resident in a foreign country, it must report the bank balance to the CRA. This is true even though the funds of the charity are not taxable in the hands of the director. Predictably, there are penalties for the banks that do not comply.

The difficulty is that this new system imposes both costs and penalties on the banks. Banks, being notoriously risk averse, therefore evaluate the risk of additional costs in opening new accounts – even of existing customers. And, where it deems the risk of the potential costs of opening the account unacceptable it refuses to open the new account – a process called derisking. By refusing to open up these accounts, the banks have effectively avoided the risk and therefore the cost.

In Canada, we have not yet heard of registered charities or not-for-profits being denied banking services. However, those organizations that operate overseas, even in the United States, are being de-risked. To that end, organizations are unable to open up accounts in certain banks and, where the same analysis is conducted by multiple banks, are effectively blackballed from opening up any accounts at any bank in certain countries.

The net effect is that Canadian charities are being denied the opportunity to open up bank accounts in foreign countries. For countries that operate through agents in these countries the

inability to open an account may be minimally impactful. But for charities that undertake operations in the foreign country it is necessary to open an account to ensure proper control and direction over the funds spent in that country. Moreover, it is inevitable that in countries where entities are being denied banking services, they will undoubtedly turn to private banking structures with greater cost, lesser security and increased opacity.

The CRS has only been recently passed in Canada, and is relatively new around the world, but an objective reading of the CRS makes it obvious that the law will impose greater obligations on banks over time. As the potential costs go up banks will undoubtedly respond with a stricter cost benefit analysis for each new account. And, in turn, charities will be further denied banking services.

While it is unfortunate that the ITA has created a new regime, which has the effect of undermining its own requirement for charities to have control and direction over their funds, it is still the charity's responsibility to meet the various requirements of the Act. Organizations operating overseas will need to give serious thought to meeting the various requirements, particularly if it is engaging in sophisticated financial arrangements.