

Tax Topics

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NEW IN 2019: THE CBCA'S BENEFICIAL OWNERSHIP REGISTER

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Recent amendments to the *Canada Business Corporations Act* ("CBCA"), introducing for each private CBCA corporation (i.e., CBCA corporations other than reporting issuers and publicly listed corporations) (a "CBCA Corporation") a register listing the actual individuals (i.e., physical persons) with significant control in fact over the corporation (the "Register"), including individuals who are beneficial shareholders with significant control, is likely to affect the practice of corporate, business, and tax law in 2019 and beyond. Some of the steps for establishing and maintaining the Register, the potential penalties for non-compliance, and the reasons for these new rules (according to the government, the need to combat tax evasion, money laundering, and terrorism financing), and also some issues relating to interpretation of the rules, will be referred to below.

The amendments were introduced in the late October 2018 federal budget bill, received royal assent on December 13, 2018, and will come into force on June 13, 2019, by which time a CBCA Corporation should have established its Register. Most of the rules will be at new sections 21.1 to 21.4 of the CBCA, and in a nutshell

- (a) define an individual with significant control over a CBCA Corporation (an "ISC") as an individual who is a registered or beneficial owner of, or who has direct or indirect control or direction of, either 25% or more of the voting rights of all of the corporation's outstanding shares or 25% or more of all of the corporation's shares measured by fair market value;
- (b) consider two or more individuals to be one ISC if they are joint owners or have an agreement to act jointly;
- (c) include as an ISC an individual who has direct or indirect influence that, if exercised, would result in control in fact of the corporation;
- (d) require the corporation to at least once per year take reasonable steps to identify its ISCs, and to also record updates within 15 days of having become aware of them by any means; and
- (e) if the corporation requests Register-related information from a shareholder, the shareholder then has a positive obligation (rare under the CBCA) to reply accurately and completely as soon as feasible to the best of their knowledge.

As for the content of the CBCA Corporation's Register, it will include:

- the name, date of birth, and last known address of each ISC;
- the day on which each individual became or ceased to be an ISC;

- a description of the ISC's interests and rights in respect of shares of the corporation; and
- the "jurisdiction of residence for tax purposes" of each ISC.

As for who has access to the Register, it seems broad. Although the Register is not public and therefore perhaps can be said to be internal, the Director under the CBCA can request access, and any shareholder or creditor of the corporation or their personal representatives can obtain access so long as they are to use the information therein in connection with "any matter relating to the affairs of the corporation", including offers to acquire securities of the corporation.

These rules cannot be ignored, as non-compliance has material potential penalties (although the extent of enforcement is not yet known), with corporations or their directors, officers, or shareholders in violation of their obligations being subject to a fine not exceeding \$200,000 or six months imprisonment or both.

Non-compliance will be underlined by these new rules requiring the Register to state the annual reasonable steps taken by the corporation to keep the Register up-to-date.

Those with access to the Register include the corporation's creditors, which would presumably include the tax department when there are tax debts, and that access is available at a stage that is well before an examination connected to litigation. Also notable is that the information collected goes beyond the listing, at Schedule 50 of a corporation's annual T2 tax return (submitted to the tax department), of the corporation's 10 largest shareholders holding 10% or more of the corporation's common and/or preferred shares.

So as to help in the interpretation of these new rules in the CBCA, it seems relevant to briefly look at some of the apparent reasons for their enactment.

The federal, provincial, and territorial finance ministers came to an agreement (published in December 2017 on the Finance Canada website) to strengthen beneficial ownership transparency to among other things prevent corporations from being misused for tax evasion, money laundering, corruption, and the financing of terrorist activities. This is to be accomplished through the pursuit of legislative amendments "to ensure corporations hold accurate and up to date information on beneficial owners that will be available to law enforcement, and tax and other authorities." The ministers agreed to make best efforts to put forward legislative amendments to bring these changes into force by July 1, 2019. It seems then that this is what prompted the abovementioned new CBCA Register of ISCs and its timeline for taking effect, and although the provinces and territories have not yet introduced similar legislation for corporations subsisting under their corporate legislation, one can surmise that at least some of them will do so soon.

Foreshadowing of these CBCA amendments can also be found elsewhere, and perhaps underlines that a main intended user of the Registers will be Canada's financial institutions. For example, it is noted in the "[Beneficial ownership requirements](#)" May 1, 2018 guidance listed on the website of the Financial Transactions and Reports Analysis Centre of Canada ("FINTRAC") that financial institutions must obtain and take reasonable measures to confirm beneficial ownership information of, for example, new clients, that for a corporation the beneficial owners would be seen as the actual individuals who are the ultimate owners or controllers of 25% or more of the corporation, and that the financial institution must search through as many levels of information as necessary (in records such as minute books, articles of incorporation, annual returns, shareholders agreements, and board decisions) to determine the actual individuals. It seems then that one of the purposes of the new CBCA Register of ISCs is to provide an additional useful corporate record to help financial institutions meet their demanding "know your client" requirements. For its part, the tax department has ample ability under its audit powers to obtain information beyond what will be in the Register, which perhaps indicates that it would have been able to get along well enough without the Register.

It seems clear, especially given this FINTRAC guidance, that whether or not there are nominee owners (often referred to in Quebec as *prête-nom* owners) among the direct and indirect shareholders of the Corporation, the Register is supposed to show the actual individuals (not another corporation, and not a trust or other entity) who ultimately own or control, directly or indirectly, at least 25% of the Corporation in votes or value.

As each CBCA Corporation and its advisors now grapple with interpreting these new rules and monitoring future developments in this area, the following issues seem useful to keep in mind:

- It does not appear useful at this time to try to avoid the new rules by continuing a CBCA corporation into a province or territory through the corporate export-import process, given that the other jurisdictions have provided a commitment to introduce similar legislation.

- What does it mean to have 25% of the “voting rights” attached to “voting shares” of a corporation? In unclear cases, perhaps interpretive assistance can be found in other legislation. For example, Quebec legislation on land transfer tax was recently amended so as to refer to voting shares as being those with “voting rights that may be exercised under any circumstances at the annual meeting of shareholders” of the corporation.
- In unclear cases, how does one know if an individual has “direct or indirect control” or “direct or indirect influence that if exercised would result in control in fact”, and how are “interests and rights in respect of shares” to be described? In cases where standard corporate and tax authority on control does not sufficiently assist, perhaps inspiration can be found in other new areas dealing with beneficial ownership (such as British Columbia’s new rules for its public registry of real property beneficial ownership, referring to individuals with a “significant interest” in a corporation or trust; the Ontario *Business Corporations Act*’s new rules requiring a register of an Ontario corporation’s “ownership interests” in land; or the UK’s 2016 rules for their register of people with significant control of private companies and other entities). Furthermore, and given for example FINTRAC’s reference to the importance of looking to shareholders agreements and related records to determine beneficial ownership, it seems logical to also look to private equity and related investment agreements that provide, among other things, for options to convert debt and other rights to shares and/or that provide rights relating to major management decisions. Additionally, it seems that if necessary, the Register should include a narrative where a longer or conditional response is warranted. As precedent for such longer answers, look perhaps to the July 2018 draft federal legislation that increases filing requirements, and disclosure requirements as to trust beneficiaries and others, for trust tax returns for years ending after December 30, 2021, regarding which Finance Canada has commented that where for example a trust has future beneficiaries, details of the trust should be provided.
- It could be tricky to deal with situations where a trust is a shareholder. For example, for a discretionary family trust holding the non-voting common shares of the corporation, certainly value has to be considered. In the past, there has been a certain unresolved tension on the valuation issue, the standard business valuation view probably being that a discretionary trust interest is speculative and therefore has nil value, but with family law often taking the position that you “cannot trust the trust” and ascribing a kind of financial means and perhaps other rights and obligations to a trust beneficiary with, for example, a history of receiving trust income. Given the new Register for CBCA Corporations, hopefully a narrow interpretation can be cast on the CRA’s apparent view that a reasonable method to value a disposed trust interest would be to value the interest as if the trust assets were fully distributed equally among all the discretionary beneficiaries (CRA document no. 2001-0111303, “Beneficiary added to discretionary trust”). Potentially, at least based on that family law-like point of view, value may be with the beneficiaries, rather than, say, the trustees. For Quebec trusts (where art. 1275 of the *Quebec Civil Code* requires an independent trustee, such as a professional), if value is with the trustees, then there may be a need to have a non-family member, the independent trustee, listed as an ISC.
- What is the “residence for tax purposes” of an individual? Can it be argued that the CBCA is a federal statute, and that tax residency from a federal perspective for many purposes does not concern itself with the provincial residence, such that the answer for residency on the Register is Canada or a foreign country? Possibly, but given that many of the provinces and territories are likely to enact a similar register under their respective corporate statute, the question of where in Canada the residence is located likely will have to be addressed.
- When does a matter “relate to the affairs of the corporation” so that a shareholder or creditor can have access to the Register? “Affairs” of a corporation seems to be a very broad term. Note for example that section 146 of the CBCA refers to a unanimous shareholder agreement (a “USA”) as dealing with the business and affairs of the corporation, and given for example that it is common for a USA to deal with corporate powers to create debt and obligations, it would seem that a creditor’s rights in relation to a debt of the corporation owed or allegedly owed to the creditor relate to the corporation’s affairs, and allow access to the Register. If a trade creditor cannot have broad access to the Register, that potentially weakens broad access rights of the tax department and financial institutions.
- In line with the “private issuer” definition under section 2.4 of national securities instrument 45-106, a CBCA Corporation will want to have its shareholders confirm that they are receiving issued shares as the beneficial owner thereof, and this is commonly done at present. The new CBCA amendments raise the question of how much further a CBCA Corporation must go to reasonably determine the individuals with significant control over the corporation.

- The recent CBCA amendments refer to the possibility of future prescribed regulations to flesh out the rules further, mostly as regards possible further exemptions from the rules (beyond the exemption for public corporations), deeming rules for determining ISCs, additional content for the Register, steps for how the Corporation can reasonably obtain ISC information, and the form of the Register and how to prepare and maintain it. (The current lack of a prescribed form does not, however, excuse a CBCA Corporation from complying.) Hopefully there will be regulations and/or additional amendments that clarify and reduce the corporation's burden in collecting ISC information, perhaps relieve corporations seen as "low-risk" from having a Register (for example, corporations with lower levels of revenue and/or assets), and solve some of the interpretive difficulties referred to above.
- The finance ministers stated in their abovementioned 2017 agreement that increased beneficial ownership transparency would be available also to "law enforcement", so it may be that police services will in the future get express access to the Register. However, there seem to be no specific governmental indications that the rules will be further changed to put the Register in the public domain. Although the UK has had a public register of persons with significant control since 2016, with information analogous to what is called for in the CBCA's Register, contrary to the UK, Canada is a federal state where implementation of a public register for all corporations, incorporated at whatever jurisdiction (federal, provincial, or territorial), would be difficult, and the purpose of providing financial institutions, the tax department, and perhaps the police with useful ISC information seems sufficiently served with a non-public register of the kind just added to the CBCA.

Therefore, each CBCA Corporation is required by mid-June 2019 to establish under newly enacted rules a register of individuals with significant control over the corporation. The rules may change to an extent under future regulations or amendments, and the provinces and territories may enact similar rules for corporations subsisting under their corporate statutes. These are notable developments indeed.

CURRENT ITEMS OF INTEREST

Government Proposes Tax Relief to Employees Who Are Overpaid

On January 15, 2019, the federal government announced a consultation on proposed rules which will provide tax relief to public service employees who have been overpaid by some fault of the Phoenix pay system. That said, the changes will apply uniformly to all private and public sector employees.

Where an employee is erroneously paid too much in a taxation year, and that overpayment is discovered and rectified in a subsequent taxation year, the employee is required to pay the employer back the gross amount of the overpayment (rather than the amount net of deductions for income tax, CPP, and EI). The employee is then required to recover the deducted amounts directly from the CRA. In other words, an employee is required to pay back more than the net amount that they actually received; this could cause significant financial hardship, especially when the system can also leave a public service employee underpaid.

Currently, if the overpayment is paid back in the taxation year in which it was paid, the employee can pay back the net amount to the employer. The draft tax rules propose to extend this treatment to overpayments that are repaid within three calendar years after the year of the overpayment. Employees will repay the net amount, and instead the employer will recover the deducted amounts from the CRA. A key requirement in the proposed rules is that the amount must have been paid as a result of a clerical, administrative, or system error. Moreover, the employer is required to elect in a prescribed form in order for this repayment provision to apply, and an information return that corrects the overpayment cannot have been issued prior to the election being made. These proposed rules will apply to overpayments made after 2015.

The proposals will accordingly amend the *Income Tax Act*, *Canada Pension Plan*, and *Employment Insurance Act* to this effect. Comments on these proposals must be submitted by February 15, 2019.

RECENT CASES

Appeal from inclusion in income of amount provided by employer for travel costs dismissed

During the 2014 tax year, the taxpayer received from his employer an amount intended to offset personal travel costs between his home in New Brunswick and the pick-up point in Alberta from which his employer provided transportation, at the employer's expense, to a mining work site in Yellowknife. During that year, the taxpayer's actual costs for travel from his home to the pick-up point were \$10,383.40 while the allowance received was \$5,749.70. The employer refused to provide the taxpayer with a completed Form TD4 Declaration of Exemption — Employment at a Special Work Site, which would have allowed the amount to be excluded from income. Rather, the amount of the allowance was reported on the taxpayer's T4, included in income, and taxed as such. The taxpayer appealed, arguing that the allowance should be exempt from tax based on his work at a remote work site.

The appeal was dismissed. The Tax Court of Canada noted that, generally, all benefits received by an employee from an office or employment are taxable in his or her hands, and that section 6 of the *Income Tax Act* provides an exception to that general rule by allowing certain benefits related to special work sites or remote work locations to be excluded from income, in limited circumstances. The Court reviewed the reasoning of the employer in refusing to issue the TD4 Declaration of Exemption, and held that it could not conclude that the employer was acting unreasonably or in bad faith. In order to qualify for the exemption, an allowance paid must be for transportation between the employee's home and the special work site. However, the allowance paid to the appellant was paid for travel between his home and the pick-up point in Edmonton, which was not a special or remote work site. The Court noted as well that the amount of the allowance, which was set at 4.5% of salary, was arbitrary and bore no resemblance to the appellant's actual travel costs. The Court concluded that the appellant's costs in travelling to the pick-up point were essentially personal in nature. The jurisprudence was clear that where such personal costs are paid by an employer, the amount received gives rise to a taxable benefit, which was properly included on the appellant's T4. The appeal was therefore dismissed.

¶50,120, *McEachern v. The Queen*, 2019 DTC 1001

Minister's application for determination of question under s. 174 denied

A group of 42 taxpayers filed Notices of Objection to assessments finding that they had participated in a tax shelter, but no appeals were filed. The Minister then brought an application under section 174 of the *Income Tax Act*, seeking a determination by the Tax Court of Canada as to whether the investments made by the taxpayers constituted a tax shelter.

The application was denied. The Tax Court held that, under section 174 of the *Income Tax Act*, it was allowed to hear a question arising out of substantially similar transactions or occurrences. However, before the Court exercises its discretion to hear such an application, it must be satisfied that the question is common to assessments or proposed assessments and the burden is on the Minister to satisfy the Court that such is the case. As well, the Court must ensure that the exercise of its discretion does not result in an abuse of process, that all parties are treated fairly, and that issues raised are resolved in the most expeditious and least expensive way. The Court reviewed the history of the proceedings before finding that, while the question was common with respect to certain assessed taxpayers who were named in the application, it would not exercise its discretion to hear the application. In the Court's view, an order directing that a hearing be held involving 42 different parties would not be fair to those parties, especially the self-represented. The Court held that the question before it was one of mixed law and fact, for which evidence would need to be provided at a hearing and that would require the holding of discoveries. It concluded that the most just, expeditious, and least expensive manner of determining the issues raised by the assessments was through the hearing of the existing lead cases, and that the Minister should, as respondent in those cases, have brought an application under Rule 58 of the *Tax Court of Canada Rules (General Procedure)*. The Court concluded that, in the circumstances, the Minister's choice to instead bring an application under section 174 represented an abuse of process, and the application was denied.

¶50,121, *Canada (MNR) v. Boguski*, 2019 DTC 1002

Appellant's motion to call more than five expert witnesses at trial denied

Section 145 of the *Tax Court of Canada Rules (General Procedure)* requires that, where a party intends to call more than five expert witnesses at a hearing, such party must obtain leave of the Court. The corporate appellant brought a motion seeking leave of the Court to call seven expert witnesses at trial.

The motion was denied. The Court noted that applications for leave to call more than five expert witnesses are considered on a case-by-case basis, and the jurisprudence provides that such leave shall not be granted lightly. In considering whether to grant leave, the Court must consider the nature of the proceeding, the public significance of the issues and any need to clarify the law. As well, the number, complexity, and technical nature of the issues in dispute must be weighed. The expense of calling the expert witnesses in relation to the amounts in issue and the potential for duplication of expert witness testimony are also factors. Finally, the Court must consider the timeliness of the motion and any prejudice to the other side. The Court reviewed each of those factors as they applied to the motion before it, as well as the jurisprudence interpreting those factors. It concluded, based on that review, that only one of those factors — that the cost of calling two additional witnesses was small compared to the amount in dispute — supported the appellant's motion. Each of the other factors, however, weighed against granting the motion. The Court concluded that the mere fact that a significant amount of money was at stake was an insufficient reason to allow the motion. The motion was denied, with costs of the motion awarded to the respondent.

¶50,122, *CIBC v. The Queen*, 2019 DTC 1003

INTERNATIONAL NEWS

Final Tax Cuts and Jobs Act Transition Tax Regulations Issued

The Treasury and IRS have issued final regulations for determining the inclusion under Code Sec. 965 of a US shareholder of a foreign corporation with post-1986 accumulated deferred foreign income. The tax imposed on the inclusion is referred to as the transition tax. The final regulations retain the basic approach and structure of the proposed regulations, with certain changes. This item was published without a TD number. According to the IRS, a TD number will be assigned after the IRS resumes normal operations.

The final regulations generally apply beginning in the last tax year of the foreign corporation that begins before January 1, 2018, and with respect to a US person, beginning in the tax year in which or with which such tax year of the foreign corporation ends.

Controlled Domestic Partnerships

Certain controlled domestic partnerships may be treated as foreign partnerships for purposes of determining the section 958(a) US shareholders of a specified foreign corporation owned by the controlled domestic partnership and the section 958(a) stock owned by the shareholders. The definition of controlled foreign partnership is revised so that it is not determined just with respect to the US shareholder, so that the controlled foreign partnership is clearly treated as a foreign partnership for all partners if the rule applies.

Definition of Pro Rata Share

The definitions of "pro rata share" and "section 958(a) U.S. shareholder inclusion year" are modified. The final regulations will require a section 965(a) inclusion by a section 958(a) US shareholder in a case in which the specified foreign corporation, whether or not it is a controlled foreign corporation ("CFC"), ceases to be a specified foreign corporation during its inclusion year.

Downward Attribution Rule

A special rule applies when determining downward attribution from a partner to a partnership where the partner has a *de minimis* interest in the partnership. The threshold for applying the special attribution rule for partnerships is increased from five to 10 per cent and is extended to trusts.

Basis Election Rules

The final regulations allow a taxpayer to elect to increase its basis in the stock of its deferred foreign income corporations ("DFICs") by the lesser of its section 965(b) previously taxed earnings and profits ("E&P") or the amount it can reduce the stock basis of its E&P deficit foreign corporations without recognizing gain. Within limits, a taxpayer may designate which stock of a DFIC is increased and by how much.

Exception From Anti-Abuse Rules

The final regulations provide an exception from the anti-abuse rules for certain incorporation transactions. The rules will not apply to disregard a transfer of stock of a specified foreign corporation by a US shareholder of a domestic corporation, if certain requirements are met:

- the section 965(a) inclusion amount with respect to the transferred stock of the specified foreign corporation must not be reduced, and
- the aggregate foreign cash position of both the transferor and the transferee is determined as if each had held the transferred stock of the specified foreign corporation owned by the other on each of the cash measurement dates.

Cash Position

Foreign earnings of a domestic corporate US shareholder are taxed at a rate of 15.5 per cent, if held in cash, but only 8 per cent if held otherwise, under Code Sec. 965. Cash includes cash and cash equivalents. The final regulations provide a narrow exception from the definition of cash position for certain commodities held by a specified foreign corporation in the ordinary course of its trade or business, as well as for certain privately negotiated contracts to buy and sell these assets.

Election and Payment Rules

The final regulations clarify that the signature requirement on an election statement is satisfied if the unsigned copy is attached to a timely-filed return of the person making the election, provided that the person retains the signed original in the manner specified.

Transition rules for filing transfer agreements have also been updated. If a triggering event or acceleration event occurs on or before December 31, 2018, the transfer agreement must be filed by January 31, 2019. Rules are added to address the death of an S corporation shareholder transferor. The final regulations also include modifications to certain requirements for the terms of a transfer agreement.

The final regulations provide that in the case of an additional liability reported on a return or amended return, any amount that is prorated to an installment, the due date of which has already passed, will be due with the return reporting the additional amount. The rule with respect to deficiencies remains the same, and payment for a deficiency prorated to an installment, the due date of which has already passed, is due on notice and demand.

Total Net Tax Liability Under Code Sec. 965

A taxpayer may elect to defer the payment of its total net tax liability under Code Sec. 965(h) and Code Sec. 965(i). Total net tax liability under section 965, which defines the portion of a taxpayer's income tax eligible for deferral, is equal to the difference between a taxpayer's net income tax with and without the application of Code Sec. 965. The final regulations will disregard effective repatriations taxed similarly to dividends under Code Sec. 951(a)(1)(B) resulting from investments in US property under Code Sec. 956 when determining net income tax liability without the application of Code Sec. 965.

Consolidated Groups

The consolidated group aggregate foreign cash position is determined under the final regulations as if all members of the consolidated group that are section 958(a) US shareholders of a specified foreign corporation are a single section 958(a) US shareholder.

Previous Guidance Obsolete

The following previous guidance is obsolete:

- Notice 2018-7, I.R.B. 2018-4 I.R.B. 317;
- Notice 2018-13, I.R.B. 2018-6 341, Sections 1 through 4 and 6;
- Notice 2018-26, I.R.B. 2018-16 I.R.B. 480, Sections 1 through 5 and 7; and
- Notice 2018-78, I.R.B. 2018-42, 604, Sections 1 through 3 and 5.

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