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UPDATE ON BENEFICIAL OWNERSHIP TRANSPARENCY UNDER THE CBCA, ONTARIO, AND QUÉBEC MODELS

— Daniel Frajman *TEP*, Spiegel Sohmer Attorneys, Montréal, Québec

This article will briefly review some of the major similarities and differences between the rules under the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 ("CBCA") model and the model under Québec's provincial and extra-provincial corporate registration statute, *An Act respecting the legal publicity of enterprises*, CQLR, c. P-44.1 (the "Québec Legal Publicity Act" or "QLPA") (the "Québec model"). These models require private corporations to record individuals with significant control over the corporation ("ISCs") as they are known under the CBCA model, and individuals who are the ultimate beneficiaries ("UBs") as they are known under the Québec model. The main elements of the ISC definition under the CBCA model are found at section 2.1 of the CBCA, and the main elements of the UB definition under the Québec model are at sections 0.4 to 0.7 of the QLPA. The goal of these definitions is to determine the individuals (i.e., natural persons) with significant control of the subject corporation by looking through as many levels of information as necessary, including looking through levels of shareholdings that may include holding corporations or trusts, and reviewing corporate documents including shareholder agreements and other commercial and contractual arrangements, regardless as to whether shareholdings are subject to nominee agreements.

This review is of interest because Canada's federal and provincial jurisdictions are for the most part proceeding with their commitment under a December 2017 agreement of the federal, provincial, and territorial finance ministers to amend the relevant legislation to ensure that corporations internally hold accurate information on beneficial ownership of issued shares and to make that information available to law enforcement and tax and other authorities. As a result, the CBCA model came into force in June 2019, and substantially similar rules to amend the respective provincial corporate statutes are in force or close to being so in several provinces, e.g., Manitoba, Prince Edward Island, Saskatchewan, and Nova Scotia. British Columbia has put into place a similar model. Notably, Ontario released draft legislation on November 4, 2021 as part of Bill 43, the *Build Ontario Act (Budget Measures), 2021* (the "Ontario Bill"), to adopt provisions substantially similar to the CBCA model as proposed amendments to the Ontario *Business Corporations Act*, R.S.O. 1990, c. B.16, which would come into force on January 1, 2023 if the Ontario Bill is passed as expected.

Similarly, Québec has moved along with the commitment made by the finance ministers by enacting, with some last-minute changes, the final version of its Bill 78, *An Act mainly to improve the transparency of enterprises*, S.Q. 2021, c. 19, on June 8, 2021, which makes the Québec model a part of the QLPA. The Québec model is not yet in force, awaiting proclamation from the Québec government which currently is scheduled to occur by October 2022 according to its most recent announcement. The Québec model is unique in North America in that it is not internal to the corporation, but rather

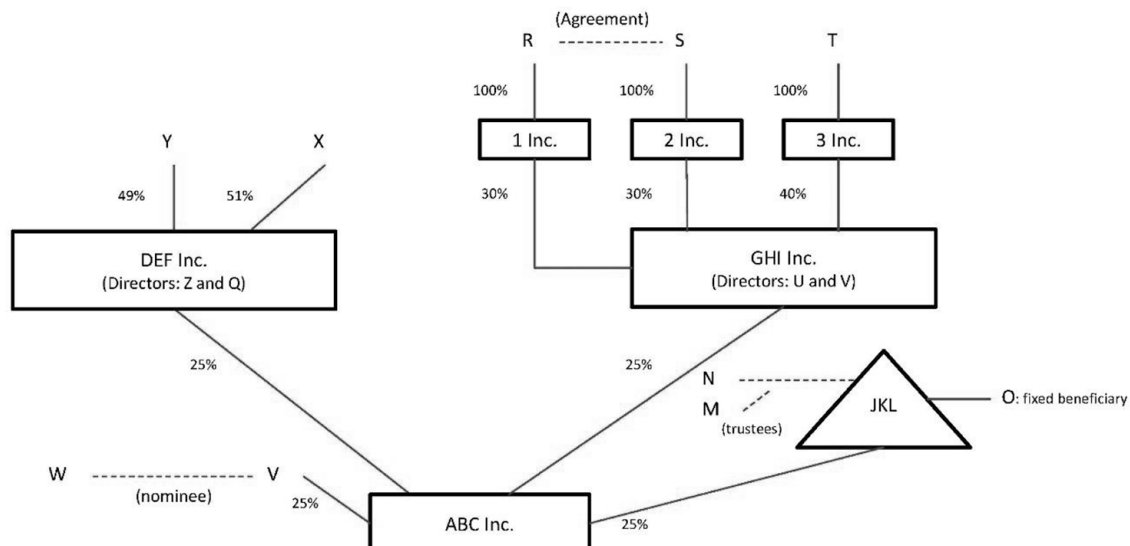
provides for a public register (the "Québec Enterprise Register") that lists UBs, to be freely accessible (and searchable by names of corporations, ultimate beneficiaries, directors, and principal officers) at: www.registreentreprises.gouv.qc.ca/en/.

The Québec model essentially applies to any corporation incorporated in Québec, or anywhere else in the world but with activity in Québec such that it is required to extra-provincially register in Québec; hence, the Québec model and the need to accurately record UBs must also be considered by those outside of Québec. What follows below is a brief review of how each of the CBCA model and the Québec model determine respectively ISCs and UBs in certain common scenarios. The Québec register also requires registration and listing of UBs for other entities carrying on activity in Québec, such as private business trusts (not family trusts with passive investments which do not have to be registered), general partnerships, and limited partnerships (with very generally UBs for partnerships determined by application of the corporate UB rules, *mutatis mutandis*). These other entities will not be dealt with in this article (except for trusts when they come up in the example below as a shareholder of the subject corporation). As will also be referred to below, the notion of *de facto* control of the corporation by a UB under the final legislation for the Québec model, and by an ISC under the Ontario Bill, was further developed in 2021 with inclusion in the Québec model of the *de facto* control rules currently found at sections 21.25 and 21.25.1 of the Québec *Taxation Act* (the "QTA") (which are essentially the same as the current *de facto* control rules at subsections 256(5.1) and (5.11) of the *Income Tax Act* (Canada) ("ITA")), and the apparent inclusion in the Ontario Bill of the just-mentioned rules under the ITA for *de facto* control.

It will be interesting to see if the Québec model comes into force by October 2022 as currently scheduled. It will also be interesting in 2022 to see if further guidance as to how to determine ISCs and UBs is received from governments through either regulations or administratively (such guidance has not yet been received for either the CBCA model or the Québec model). A question and answer page posted by Québec on June 23, 2021 on the above-mentioned site of the Québec Enterprise Register appears to promise administrative guidance on UB determination in 2022 in advance of the Québec model coming into force.

An Example

The following corporate chart is the example that will be used when referring to some of the major similarities and differences between the rules under the CBCA model for determining ISCs, and the rules under the Québec model for determining UBs. It will be seen that questions and grey areas remain in making the determinations. In this example, the subject corporation, ABC Inc., for which the ISCs or UBs must be determined, is a CBCA corporation carrying on business in Québec, so its ISCs under the CBCA model (the "ISC rules") and its UBs under the Québec model (the "UB rules") must be determined. Assume in this example one class of voting common shares throughout. Individuals are referred to on the chart by standalone letter.



Direct and Indirect Ownership

Under both the ISC rules and UB rules, the goal essentially is to determine those individuals with at least 25% of the votes or fair market value of the subject corporation arising from shares of the corporation, so long as those individuals are a registered holder or beneficial owner (or additionally under the ISC rules, have direct or indirect control or direction) of the shares in question, or those individuals with control in fact (*de facto* control) of the corporation.

As regards holding or owning shares, the ISC rules look only at direct ownership (as apparently the default corporate law rule would apply, which recognizes direct ownership of shares and not indirect ownership, pursuant to long-standing principles (see, for example, *Army and Navy Department Store Limited v. Minister of National Revenue*, 53 DTC 1185 (SCC)). The only individuals in our example with such direct ownership of a 25% minimum in ABC Inc. are the individuals V (as registered holder) and W (a beneficial owner), who would both be ISCs.

The UB rules, as regards holding or owning shares, are different, because they specifically recognize both direct and indirect holders. Extending UB status to indirect owners can help prevent certain holders of material interests at higher levels in a tiered structure from inadvertently falling through the cracks and not being shown on the register as having significant control, as can occur under the ISC rules. In our example, in addition to the above-mentioned V and W being UBs, one must also consider Y and X who have large direct ownership interests in the holding company DEF Inc. When we consider their interests in the subject corporation ABC Inc., X and Y have indirect ownership interests that apparently are $49\% \times 25\% = 12.25\%$ for Y and $51\% \times 25\% = 12.75\%$ for X. In both cases the interests are less than 25%, and therefore neither Y nor X are UBs on this basis. Notably, since the ISC rules do not refer to indirect ownership, there does not appear to be an ability under the ISC rules to determine a percentage interest by using multiplication to obtain a product as was just demonstrated above under the UB rules.

Interestingly, although the ISC rules explicitly recognize both registered and beneficial ownership, the UB rules do not do so, but instead refer to individuals with the minimum 25% interest as "a holder, even indirectly, or [as a direct] beneficiary." Therefore, under the UB rules, it appears likely that it is simply implied that a beneficial owner is implicitly included as a direct or indirect holder as is a registered owner. On the other hand, it may be that a beneficial owner has to have a direct (not indirect) ownership interest to be a UB as a direct beneficiary, due to a definition in a somewhat related statute, the Québec *Business Corporations Act*, which at section 2 includes beneficial shareholders in its definition of "beneficiaries". In our example, the beneficial owner W has a direct (not indirect) ownership interest and therefore would be both an ISC and UB without having to address this issue.

Control or Direction

Under the ISC rules, direct or indirect "control or direction" of the minimum 25% also makes an individual an ISC. This is inapplicable to the UB rules, which have no similar provision.

In our example, who under the ISC rules has such control or direction? Most feel that this would apply to those individuals "controlling" relevant entities, such as trustees of a trust, or holders of more than 50% of the shares of a corporation. In our example, the ISCs in this regard would be trustees N and M of the JKL trust that owns the minimum 25% in the subject corporation, and would also be X, who controls (by virtue of owning 51% of) DEF Inc., which itself owns the minimum 25% in the subject corporation. Most feel this would apply also to those individuals with "direction" over relevant entities, such as directors of a corporation. In our example, the ISCs in this regard would be the directors of each of DEF Inc. and GHI Inc., corporations which both own the minimum 25% in the subject corporation.

One apparent advantage of this "control or direction" rule is that it finds ISCs where sometimes it would otherwise be difficult to find them. However, some have stated that this rule lacks precise definition and may unduly multiply the number of ISCs. This concern seems to have been expressed by Québec (which excludes such control or direction from the UB rules) and also by Ontario, given that the Ontario Bill states that Ontario may make regulations defining the meaning of an individual having "direct or indirect control or direction over shares."

De Facto Control

Both the ISC rules and the UB rules indicate, respectively, that an individual is an ISC or a UB if the person has any direct or indirect influence that, if exercised, would result in control in fact (*de facto* control) of the subject corporation. In our example, R and S, through the voting trust agreement referred to in the diagram, have *de facto* control over the

corporation GHI Inc. by virtue of being able to vote together over 50% of its shares, making R and S on that basis both ISCs and UBs of GHI Inc. Note, however, that this rule does not make R and S ISCs and UBs of the subject corporation ABC Inc., because the *de facto* control rule relates to control over the corporation in question (here, ABC Inc.), and not simply control of say a 25% minimum in votes or value of that corporation.

The CBCA provisions for the ISC rules do not define the meaning of *de facto* control, leading some to take the view that *de facto* control under the CBCA may be as set out in the tax case of *McGillivray Restaurant Ltd. v. Canada*, 2016 DTC 5048 (FCA), where similar wording in the subsequently amended provision of the ITA dealing with association describes the corporate concept of *de facto* control as the right to effect a change to the board of directors or its powers and does not extend to operational control otherwise arising. However, there would appear to be no obvious reason to prevent agreements or arrangements providing for operational control from creating *de facto* control for ISC and UB purposes, and it is probably for this reason that, as mentioned above, the UB rules, and also the ISC rules as set out in the Ontario Bill, provide a definition of *de facto* control that refer respectively to the current QTA and ITA definitions and therefore appear to explicitly include operational control. In addition to the fairly substantial case law and commentary on what constitutes *de facto* control, the current QTA and ITA definitions would appear to consider as relevant the CRA's view on general factors that may be used in determining whether *de facto* control exists as set out in paragraph 23 of Interpretation Bulletin IT-64R4 (Consolidated), Archived — "Corporations: Association and Control".

Joint Control

It's worth noting that the rule on this is wider for the ISC rules, which say that two or more individuals who jointly own the minimum 25% interest, or who have an agreement or arrangement to vote the minimum 25% interest, will all be ISCs. The Ontario Bill widens this further to also include as ISCs related parties who separately hold such rights, but their aggregate holdings are at least 25%.

The UB rule appears narrower, as it seems to refer only to an agreement relating to a minimum of 25% of the vote as giving UB status to all of the individuals with the right.

Trust as a Shareholder

In our example, the JKL trust has the minimum 25% interest in votes. As throughout our example, this would also include a 25% interest in value, since we have one class of common voting shares. Therefore, our example does not address whether particular shares have sufficient value to meet the 25% minimum. This question can arise under the ISC rules and the Québec rules, for example after an estate freeze, when common non-voting shares issued to a trust start with no value and therefore do not meet the 25% minimum, but may meet that minimum later as their value rises.

As mentioned above, under the ISC rules, trustees N and M appear to be ISCs as individuals with control. Furthermore, O would be an ISC as a beneficiary with a fixed trust interest, therefore likely being seen as a beneficial owner under the ISC rules. Most feel that under the CBCA model, discretionary beneficiaries under a trust are not ISCs, as there is no basis for it in the CBCA, which includes "beneficial owners" as ISCs but does not refer to "beneficiaries" per se. Possibly a trust beneficiary with a fixed income interest but a discretionary capital interest would be an ISC, depending perhaps on factors such as whether the capital interest vests with the beneficiary's family on the death of the beneficiary.

Under the UB rules, the trustees of JKL trust are not UBs based on control, as that is not part of the UB rules. However, although the UB rules could be clarified on this point, subsection 0.5(2) of the QLPA seems to say in a roundabout way that if a trust as shareholder meets the 25% minimum or has *de facto* control, then the UBs are the trustees (N and M in our example) and the "beneficiaries" of the trust (O in our example). It is unclear as to whether trust beneficiaries for UB purposes include discretionary beneficiaries. For example, there is a view by some in Québec that a discretionary trust beneficiary is a "candidate beneficiary" and not a trust beneficiary per se, and therefore not included as a UB.¹

The ISC rules make no distinction between *inter vivos* and testamentary trusts as shareholders. Note, however, that the UB rules (subsection 0.5(3) of the QLPA) indicate that the beneficiaries of a testamentary trust are not UBs.

¹ See, for example, Patrick Besner et al., *Panel sur la transparence corporative — Nouvelles exigences législatives canadiennes et québécoises*, in Bar of Québec, *Développements récents en droit des affaires* (2020, Editions Yvon Blais), pp. 331 and following, at p. 418. See also examples at Paul Martel, *Le nouveau registre des particuliers ayant un contrôle important* (October 29, 2019, Wilson & Lafleur; Résolution gestion corporative inc.).

An unanswered question under the ISC rules is how to deal with the situation where a trust company is a trustee of the shareholder trust, as it is unclear who might in effect be the ISC of the trust company, which is often owned by a public financial institution. Some have speculated that if necessary, the highest-level manager(s) at the trust company dealing with the trust would be named as an ISC. Contrary to this, the UB rules deal with this situation in a clear manner, as follows.

The UB rules (at sections 33 and 0.7 of the QLPA) state that a number of entities and institutions (essentially, non-profits and charities, unincorporated associations, public companies, insurers, trust companies, and banks) do not have to declare their UBs,² and also contains curious wording to the effect that these entities and institutions are considered to be individuals (natural persons) for the purposes of the UB rules. That latter reference is in fact helpful, in that it has the effect, when one encounters such an entity or institution with a sufficient interest when determining UBs, to stop at that entity or institution and consider it to be a UB. One result of this: to the extent that a trust with a sufficient interest in or *de facto* control of a subject corporation has to name its trustees as UBs, if there is a trust company trustee, then that trust company (although it is not in actual fact an individual) can be named as a UB.

Director Identification

Once the UB rules are in force, all registrants on the Québec Enterprise Register will be obliged to provide to the Register a copy of identification issued by a government authority for each director (not for each UB per se). Presumably, this is one further way to assure the veracity of the Register. Interestingly, the above-mentioned Québec Enterprise Register Q&A of June 23, 2021 notes that the public nature of the Register will also help flag potential errors and maximize the accuracy of the Register.

Transitional Period

A registrant on the Québec Enterprise Register will not have to declare its UBs until it files its first annual update after the coming into force of the UB rules. Notable among the penalties for violating the QLPA, in addition to possible fines, is the possible striking off of a registrant from the Québec Enterprise Register, which would in effect prevent that registrant from carrying on business or other activity in Québec.

In conclusion, as time passes we continue to have more questions answered as to how to deal with the rules for determining individuals with significant control under the CBCA model and ultimate beneficiaries under the Québec model. Further questions will hopefully be answered on a timely basis through regulations and administrative guidance. In some ways, Québec's UB register, when it comes into force, will be for now Canada's *de facto* public beneficial ownership register as regards corporations and often their shareholders, insofar as the Québec register applies essentially to entities carrying on activity in Québec regardless of where the entity is formed. One of the reasons why the Québec register will be public is probably because it has a stated goal of essentially leveling the economic playing field among contractual counterparties, in addition to the often-cited purposes of the CBCA model of combatting tax evasion, undue tax avoidance, money laundering, and terrorist financing.

² Not requiring these entities to declare their UBs reduces their reporting requirements, is in accordance with the ISC rule that public companies are not subject to these transparency rules due to their own public company transparency requirements being sufficient, and essentially shields from the UB rules various entities that would otherwise be subject to those rules due to essentially all entities with activity in Québec having to register under the QLPA.