

In-House Counsel

Public beneficial ownership registers and trust beneficiaries: Different jurisdictions, part one

By **Daniel Frajman**

Daniel Frajman

(July 13, 2023, 9:10 AM EDT) -- As we guide our clients through new legislation relating to beneficial ownership reporting for private company shares, including as regards shareholders that are trusts, it is worthwhile to look at the apparent jurisdictional inconsistencies. In this two-part series we will compare government policy at the Canadian federal and provincial levels and in the U.S. federally, relating to two of the major aspects of the rules: the extent of the public aspect of the reporting, which will be looked at in this article, and the manner in which discretionary trust beneficiaries are reported, which will be looked at in the second part of this series.

This can help promote an understanding of and perhaps a change for the better as regards this legislation aimed at increasing transparency.

Public aspect of reporting

The rules for the reporting of beneficial ownership of private company shares go beyond just beneficial ownership, and generally are aimed at looking through all the holding companies and trusts in the corporation's structure so as to determine and then report the identity of all physical persons who hold at least 25 per cent of the votes or value of the corporation in question, or who control in fact — have *de facto* control — of the corporation. (For some reason, British Columbia replaces the value criterion with individuals holding 25 per cent of the number of issued shares, which is probably misleading.)

The Canadian division of powers allows corporations to be incorporated provincially or territorially, or at the federal level, and currently all the jurisdictions (other than Alberta and the territories which have no such legislation, and Quebec which has a different system) have this beneficial ownership legislation with regard to corporate shares, as part of each jurisdiction's business corporation legislation. In other words, for the most part, this legislation in each Canadian jurisdiction (including in Ontario since Jan. 1, 2023) is limited to corporations incorporated in that jurisdiction.

Quebec is an exception on this latter point, as its rules on this are in Quebec's provincial and extra-provincial corporate and partnership registration legislation, *An Act respecting the legal publicity of enterprises*, with the result that any corporation or partnership (and certain other entities) formed anywhere in the world, and with activity in Quebec, would be subject to this reporting on the Quebec register, known as the Enterprise Register, in effect currently making the Quebec register what can perhaps be called Canada's *de facto* national register for beneficial ownership of corporations and partnerships, including as regards their trust shareholders and unit holders.

Some find it interesting to track the terminology used to describe the physical persons with the requisite ownership or control that must be named on these registers in the various jurisdictions (the physical persons are known as individuals with significant control in Canada federally and in the provinces with legislation other than Quebec and British Columbia, ultimate beneficiaries in Quebec, significant individuals in British Columbia, beneficial owners in the U.S., persons with significant control in the U.K. and ultimate beneficial owners in France, Germany and other EU jurisdictions).

The more important issue is whether or not the establishment of the identity of such true owners and controllers is reported in a publicly accessible register (rather than retaining significant confidentiality by being maintained in the corporation's own records or being submitted to governmental authority subject to restricted access).

In trying to determine whether a North American jurisdiction will require public access, an argument can be made that one looks to the public policy rationale for the register, and that those jurisdictions aiming to use the registers to combat public ills such as tax evasion, abusive tax avoidance, money laundering and terrorist financing, tend to not record this information publicly, with availability of the information to tax, law enforcement and other governmental authorities being seen as sufficient. This is the case when looking at policy statements published by the Canadian government and by most of the provinces going back to a commitment that the federal government published in December 2017.

Another example of this is the following statement made in September 2022 by FinCEN, a division of the U.S. Treasury Department, indicating that the U.S. rules regarding beneficial ownership would, "enhance U.S. national security by making it more difficult for criminals to exploit opaque legal structures to launder money ... and commit serious tax fraud and other crimes." Not surprisingly in my view, Canadian jurisdictions with legislation on this matter (other than Quebec), and the U.S., currently have legislation that does not publicly register the collected information.

The Quebec rules in contrast establish a public register that is freely accessible on the Internet (which for example can be accessed by searching on the Internet the term, "Quebec corporate search"). In this regard, it is not surprising in my view that the Quebec government has added an additional goal for this legislation beyond combating tax evasion and the other above mentioned public ills, namely combating fraud generally among contractual counterparties, so as to level the economic playing field by allowing parties to know better who they are dealing with in private transactions, and additionally to allow members of the public accessing the public register to take on a whistleblower function by reporting perceived falsely declared information.

In a 2019 public consultation on corporate transparency, the Quebec government wrote, "In the fight against *fraud*, tax evasion, tax avoidance, money laundering and the financing of criminal activities ... the government is examining ... approaches ... aimed at improving transparency." [emphasis added]

In further support of this view, to the effect that public beneficial ownership registers arise when there is a desire to create a better private business environment generally, is a statement by the Canadian federal government in March 2023 when it tabled Bill C-42, which provides for amendments to our federal internal registers for individuals with significant control, to make that register a public one (as early as the end of 2023, although the bill appears unlikely to be enacted and to go into effect as early as that), and offers to the provinces and territories, for the similar internal registers for their own provincial and territorial corporations, the ability to individually join a new federal public register that would be scalable. In tabling this bill, the federal government stated that the goal of the proposed public register would be to combat tax evasion and the other public ills, and would also be aimed at, "making sure Canada is an attractive place to conduct business," and would be meant to "ensure a well-functioning marketplace."

Similarly, press reports from the time, when the U.K. opened the first publicly available corporate beneficial ownership register in 2016, indicated that one of the goals of the then U.K. government of David Cameron was to also increase the ability of persons to know the identity of their counterparties. (The U.K., which is no longer part of the EU, continues to have a public register, notwithstanding that most EU nations, currently at least, have reversed the public nature of their corporate beneficial ownership registers in response to the November 2022 decision of the European Court of Justice in the case of *WM and Sovim SA v. Luxembourg Business Registers*, to the effect that under the *Charter of Fundamental Rights of the European Union*, Luxembourg's public register was a disproportionate interference with privacy rights.)

There is at least one example in the Canadian context where a potential public corporate beneficial ownership register likely will be put into place without a stated government goal to combat fraud and/or to promote commerce generally. This is in British Columbia, where the *Business Corporations Act*, 2023 enacted in May 2023 calls for the internal B.C. transparency register relating to corporate beneficial ownership and control, to become a public register by 2025. The stated purpose of the B.C. government with regard to this potential change is to combat "money laundering or other criminal

purposes.”

Nevertheless, as referred to above, there seems to be a fair amount of consistency among the public policy considerations of various governments when deciding whether or not to create a public register for the reporting of beneficial owners and controllers of private corporations including as regards their trust shareholders. Such consistency should promote certainty and an easier discussion as to potential changes in the rules going forward.

This is the first of a two-part series. The second and last part of this series will look at how discretionary trust beneficiaries are treated in these registers when the trust in which such a beneficiary benefits is a beneficial owner or controller of the private corporation in question. On this issue, it will be seen, there apparently is less consistency as between jurisdictions, and less discussion of underlying policy, which should not be seen as something positive.

Daniel Frajman, dfrajman@spiegelsohmer.com, is a partner at Spiegel Sohmer Attorneys in Montreal. He practises financing, M&A, corporate law, business real estate and trust and tax law including the law of non-profit organizations/charities.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the author’s firm, its clients, LexisNexis Canada, Law360 Canada, or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

Business

Public beneficial ownership registers and trust beneficiaries: Different jurisdictions, part two

By **Daniel Frajman**

Daniel Frajman

(July 14, 2023, 9:08 AM EDT) -- The first part of this series found that there seems to be a fair amount of consistency among the public policy considerations of various governments when deciding whether or not to create a public register for the reporting of beneficial owners and controllers of private corporations including as regards their trust shareholders, mainly that if a government is interested in using the register's transparency to combat fraud generally, there seems to be a greater possibility that the register in that jurisdiction will be a public one.

(Other stated purposes for these registers, applying even when the register is not a public one, is that their reporting, when perhaps eventually submitted to tax authorities and law enforcement, helps combat public ills such as tax evasion, abusive tax avoidance, money laundering and terrorist financing.) Such consistency should promote certainty and an easier discussion as to potential changes in the rules going forward.

This second and last part of this series looks at how discretionary trust beneficiaries are treated in these registers when the trust from which such a beneficiary benefits is a beneficial owner or controller of the private corporation in question, typically arising when the trust in question holds at least 25 per cent of the votes or value (in British Columbia, value is replaced with the criterion of number of shares held) of the corporation in question after looking through intervening holding companies and nominees. On this issue, it will be seen, there apparently is less consistency as between jurisdictions, and essentially no discussion of underlying policy. This is something that is not positive, as it creates uncertainty in interpreting the rules, uncertainty as to whether interpretations will change in the future, and perceptions that the rules are arbitrary.

Discretionary trust beneficiaries in the reporting

Discretionary trusts, when they hold shares in private corporations, usually become shareholders for estate planning and tax purposes, such as capital gains tax reduction in various circumstances. The trust is discretionary in that the trustees have the discretion to decide who among a list of potential beneficiaries will in fact receive at any time and from time to time a distribution of income or capital from the trust.

If for example a trust holds at least 25 per cent of the voting shares, or non-voting shares that correspond to at least 25 per cent of the fair market value, of the corporation in question, generally most jurisdictions, in their beneficial ownership transparency legislation, will require that the trustees of the trust be reported as beneficial owners or controllers (called individuals with significant control in most Canadian jurisdictions, but called ultimate beneficiaries in Quebec, significant individuals in B.C., beneficial owners in the U.S., persons with significant control in the U.K. and ultimate beneficial owners in the EU).

As regards individuals who are the discretionary beneficiaries of such trusts, when are they named as beneficial owners or controllers on the beneficial ownership registers? The question is important

because the number of potential discretionary beneficiaries of a trust can be very large and subject to contingencies, making a list hard to assemble, and the potential penalties for non-compliant reporting are prohibitive. (For example, the Canadian federal rules refer to fines of up to \$200,000 in some circumstances; the U.S. rules, which are federal, refer to potential fines of \$US500 per day for non-compliance; the Quebec rules refer to the potential striking off of the corporation from the register, which is very disruptive; and in the case of registers that are publicly accessible on the Internet, such as Quebec's, incorrect reporting can mislead third parties and potentially can be embarrassing.) Here is how some jurisdictions deal with the question, and in most cases with little or no discussion as to the reason why:

- Under the Canadian federal rules (with most provinces — other than Quebec and B.C. which are referred to below, and other than Alberta which has not legislated in this area — having a similar rule under their own provincial corporations Acts), which are in the *Canada Business Corporations Act*, “beneficial owners” with a sufficient (example, 25 per cent) interest are reported as individuals with significant control. This is generally felt to include trust beneficiaries with a fixed (non-discretionary interest), and to not include discretionary beneficiaries;
- Under the Quebec rules (Quebec has North America's only public register, and some therefore call it Canada's *de facto* public beneficial ownership register given that it essentially applies to any private entity from anywhere with activity in Quebec), found in *An Act respecting the legal publicity of enterprises*, the statute refers to the term “beneficiary,” without defining the term. In late March 2023, Quebec issued an administrative position apparently indicating that only discretionary beneficiaries who have at some point received a distribution from the trust of income or capital would be named as ultimate beneficiaries. On a separate but related point, a specific rule in the statute appears to say that for all testamentary trusts, trust beneficiaries are exempt from being ultimate beneficiaries;
- In British Columbia, the *Business Corporations Act* refers to “beneficial owners,” and the B.C. government has taken the administrative position that as long as the trust is a direct owner of the requisite number of shares in the corporation in question, then all the discretionary beneficiaries are significant individuals;
- In the U.S., the federal *Corporate Transparency Act*, set to apply as of Jan. 1, 2024, as interpreted by the U.S. Treasury Department's “final rule” regulations of September 2022, indicates that a trust beneficiary is a beneficial owner if the beneficiary is the sole permissible recipient of income and principal from the trust, or if the beneficiary has the right to demand a distribution of substantially all the assets of the trust. This appears somewhat limiting; however, at least some legal writers have said that from a conservative point of view, all beneficiaries should be named as beneficial owners;
- In the U.K., the *Companies Act 2006* requires the trust beneficiary to hold the right to exercise, or to actually exercise, significant influence or control over the activities of the trust, to be a person with significant control;
- Other analogous laws in Canada dealing with transparency are not helpful, as these other laws also do not deal consistently with the discretionary trust beneficiary, and do not provide material reasoning for the government's position. For example, beginning with income tax filings for express trusts due in 2024 under the *Income Tax Act* (Canada) and the *Taxation Act* (Quebec), all “beneficiaries” must be listed in the trust's annual tax return. With regard to this, it appears that all beneficiaries must be listed, whether or not they contingent, and whether they are fixed or discretionary, based on explanatory or administrative statements made by Canada and Quebec. The Canada Revenue Agency indicated this again as late as in June 2023 at the CRA-STEP Canada Roundtable, when the CRA stated that in the context of these *Income Tax Act* trust tax return rules, very generally a beneficiary of a trust is a person who has the right to compel the trustee to properly enforce the terms of the trust, regardless of whether that person's right to the income or capital of the trust is immediate, future, contingent, absolute or conditional on the exercise of the discretion of any person;
- In another example of analogous Canadian laws looking at reporting requirements for discretionary beneficiaries, and very briefly stated, is the anti-money laundering (AML) legislation in Canada, such as the proceeds of crime legislation that requires customer due diligence by, for example, financial institutions; the Canada-U.S. agreement regarding foreign account tax compliance for Canadian accounts of U.S. persons; the *Foreign Account Tax Compliance Act* (FATCA); and the common reporting standard under the *Income Tax Act* (Canada) that refers to foreign account tax compliance for persons with a Canadian account

but who have a tax residence elsewhere other than the U.S. For all of this legislation, it appears that a trust beneficiary is named if the beneficiary has actually received a trust distribution in the year in question. This is apparently referred to in the CRA's guide of March 2022 on the Canada-U.S. *Enhanced Tax Information Exchange Agreement*.

In this brief review of the status of the discretionary trust beneficiary under beneficial ownership transparency legislation, it can be seen that there is significant inconsistency as between jurisdictions, and little discussion of underlying policy. This creates uncertainty in interpreting the rules, uncertainty as to whether interpretations will change in the future, and perceptions that the rules are sometimes arbitrary.

A lesson can be taken here from the policy statements made by governments on the question of whether the beneficial ownership registers should be made public, where the more robust policy discussion reduces uncertainty in interpretation and increases the ability to comply with the rules.

This is the second of a two-part series. Read the first article: Public beneficial ownership registers and trust beneficiaries: Different jurisdictions, part one.

Daniel Frajman, dfrajman@spiegelsohmer.com, is a partner at Spiegel Sohmer Attorneys in Montreal. He practises financing, M&A, corporate law, business real estate and trust and tax law including the law of non-profit organizations/charities.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the author's firm, its clients, LexisNexis Canada, Law360 Canada, or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

Photo credit / IconicBestiary ISTOCKPHOTO.COM

Interested in writing for us? To learn more about how you can add your voice to Law360 Canada, contact Analysis Editor Richard Skinulis at Richard.Skinulis@lexisnexis.ca or call 437-828-6772.