Federal Public Transparency Register Highlights Ongoing Concerns For Trusts

Is there such a thing as a "privately held" corporation anymore?

Effective January 22, 2024, private corporations governed by the *Canada Business Corporations Act* ("CBCA") are required to publicly disclose their individuals with "significant control" ("ISCs"); however, the ISC identification rules remain murky in their application to shareholders that are trusts. Government guidance is urgently required to ensure corporations and shareholders can properly meet these new obligations.

Registers of individuals with significant control (more commonly referred to as "transparency registers") are not a new concept in Canada and neither are the privacy law concerns that have existed since their inception. Private CBCA corporations have been required to maintain transparency registers as part of their corporate records since 2019. British Columbia created similar obligations for its private corporations in 2020. Quebec and Ontario followed in 2023, with Quebec being the first jurisdiction to create a public register of ISCs.

Private CBCA corporations now have two ISC obligations: private record-keeping of extensive ISC details and public disclosure of a limited subset of information.

The public CBCA transparency register will only disclose each ISC's full legal name, address for service (or residential address), when their status as an ISC started and/or ended, and a description of how they have significant control. Corporations must still compile additional ISC details as part of their ongoing corporate record-keeping, including each ISC's date of birth, country (or countries) of citizenship, country (or countries) where the ISC is considered a resident for tax purposes, and the ISC's residential address (even if an alternate address for service is designated publicly).[1]

Corporations must update their transparency registers at least once a year, and within 15 days of becoming informed of any changes affecting the register. Corporations must take "reasonable steps" to identify ISCs and their required details.[2]

The CBCA updates do not provide sufficient guidance for trusts to identify ISCs. This article aims to highlight these ongoing concerns in the hopes that clearer guidelines with be forthcoming.

By way of background, there are two steps to determining ISCs:

(1) Does a shareholder hold a "significant number of shares"?

(2) If yes, who are the individuals in "control" of the shares?

Concerns With Identifying a "Significant Number of Shares"

The CBCA defines a "significant number of shares" as being either 25% of more of the voting rights attached to outstanding voting shares, or 25% or more of all outstanding shares as measured by fair market value.[3]

Importantly, this is a test of votes *or value*. Holders of non-voting shares can still be ISCs if they are entitled to 25% or more of the fair market value of the corporation.

To illustrate the concerns for trusts, we can look at a classic estate freeze. Assume individual X completed a freeze of ABC Corp. whereby she now holds 1,000 Class A Preferred shares fixed in value and worth CAD$1,000,000. At the same time, a discretionary family trust for X and her family as beneficiaries (the X Family Trust) was established to hold 100 Class B Common shares, which are worth a nominal amount on issuance, but are entitled to receive all the growth in ABC Corp.'s value over and above $1,000,000.

In our example, even if the X Family Trust holds non-voting shares, it will still hold at least 25% of the fair market value once ABC Corp. is worth at least $1,333,334. Whether the X Family Trust holds a "significant number of shares" can therefore fluctuate over time, *even if the shareholdings remain unchanged*. This makes ABC Corp.'s annual review of ISC information more complicated and introduces considerable risk that it could inadvertently fail to file required ISC details.

The issue arises primarily because the CBCA is silent on how fair market value should be determined. Corporations Canada indicates that it is the amount an independent third person would pay to buy the shares in a "sale in which both persons are informed, independent, and acting in their own self-interest."[4] This is at least a starting point, but it remains unclear how ABC Corp. or the X Family Trust are to make this determination on an annual basis.

Of particular concern are the consequences if either ABC Corp. or the Trust get it wrong. Corporations are subject to a fine of up to $5,000 for failing to take reasonable steps to identify ISCs and up to $100,000 for failing to file the requisite ISC details.[5] Taking "reasonable steps" means the corporation must ask each shareholder and/or potential ISC to confirm their status and their details (if applicable).[6] Shareholders, directors, and officers are subject to fines up to $1,000,000 for non-compliance or the provision of false or misleading information.[7] Will the X Family Trust and ABC Corp. discharge their obligations by estimating fair market value based on internally generated financial statements? Is a formal valuation required annually? We simply do not know.

One thing is clear: until we have unambiguous government guidance on these issues, some form of evidence of fair market value should be kept on file when shares could potentially cross the 25% value threshold. Corporations, directors, officers and shareholders should, at minimum, review share attributes and financial statements carefully each year to determine potential ISCs, and not simply rely on determinations and filings made in previous years.

Concerns With Identifying Individuals in "Control" of Shares

In our example, let's assume the X Family Trust holds a "significant number of shares". Who are its ISCs?

The CBCA allows for control by direct ownership, control by beneficial ownership, or indirect control or direction.[8] In a trust, this could mean the trustees, beneficiaries, or even a protector or other connected party (it could even mean the settlor in certain cases). The CBCA does not go further in this regard.

Corporations Canada notes that having control over a trust, "means having authority to direct or influence the management of the trust, including directing how a trustee manages shareholders' rights, such as the right to: appoint or remove any of the trustees, direct the distribution of the funds or assets, direct investment decisions of the trust, amend the trust document, [or] terminate the trust."[9] It allows that individuals in control of the trust would have a specific role, and could be the trustee(s), beneficiaries, or any other individual who has authority or does control the trust (again, such as a protector or settlor).

The Corporations Canada guidance sounds like the "central management and control" test for determining a trust's income tax residency.[10] It's too early to tell whether Corporations Canada will interpret "control" the same way, or if the intention is to create a different standard. But the similarity should not go unnoticed by trusts and their advisors, especially considering how ISC information can be used.

In addition to the public filings required, private CBCA corporations must disclose *all* information on its transparency register to certain investigative bodies upon request, which include the Canada Revenue Agency ("CRA") and any provincial body with responsibilities like the CRA.[11] That is, all ISC information compiled in a corporation's records, including an ISC's countries of citizenship and tax residency, could be disclosed to the CRA (or provincial taxation authorities) under certain circumstances.

A trust's income tax residency is a question of fact.[12] The *Income Tax Act* and CRA set out certain deeming provisions and guidance on a trust's income tax residency, respectively. A trust makes the initial determination of whether it is a resident of a particular jurisdiction, which is a fact that can be later challenged by the CRA (with respect to income taxes to be paid in Canada). In challenging the trust's determination, the CRA has wide latitude in both the factors and evidence it can consider. It is well within reason to assume ISC filings and/or additional ISC register information could be used to challenge (or support) a trust's position on its income tax residency. As a result, trusts must review their ISC filings with income tax residency in mind and obtain tax advice immediately if ISCs are required to be listed who might challenge a particular tax residency.

This issue is further complicated if trusts hold shares in both CBCA corporations and corporations governed by Ontario's *Business Corporations Act* ("OBCA"). The OBCA is similar (though not identical) in many ISC respects, including an almost identical definition of a "significant number of shares" as the CBCA, but not when identifying individuals who can be ISCs. The CBCA simply defines an individual as a "natural person," while the OBCA excludes trustees, executors, administrators or other legal representatives.[13] This means two things: (1) a trust holding shares in an OBCA corporation will likely only have beneficiaries as ISCs (though a protector who is not a trustee but has some other form of control, or a settlor, might also qualify in rare cases), and (2) a trust holding shares in both CBCA and OBCA corporations could have different ISCs depending on the jurisdiction of incorporation of the corporation. While Ontario does not yet have a public register, should it eventually follow the federal government (and Quebec) in doing so (and it is widely expected that it will), the same trust could be forced to disclose different details publicly depending on the jurisdiction of incorporation of the corporation. Given the OBCA *does* define "control" similarly to the CBCA (though without any government guidance like Corporations Canada), it is also unclear how Ontario's position on ISCs could impact a trust's income tax position(s), especially where beneficiaries reside outside of Canada (or are simply subject to multiple income tax jurisdictions for other reasons).

The federal and Ontario differences get worse when looking at different types of trusts. Take the example of a spousal trust where the spouse is the sole trustee but is not entitled to access capital. A CBCA corporation might still find the spouse is the ISC, but an OBCA corporation could not because the spouse is not beneficially (or directly) entitled to access the shares (which are the capital) and cannot be listed as a trustee. The OBCA corporation must decide whom of the residual beneficiaries are ISCs – which could mean listing minors (though, again, OBCA registers are private records, for now). This could have the unintended effect of disclosing an individual's estate planning before the individual even discusses such plans with their family, particularly where an *inter vivos* trust is used.

Conclusions

What does this all mean for advisors? The new CBCA filings must be undertaken with great care, especially with respect to shareholders that are trusts. We do not yet know the extent of information-sharing or review that the CRA will take with respect to ISC details, but a cautionary approach is warranted either way. We cannot predict with certainty how Ontario or other jurisdictions will proceed when it comes to public filings, but if the trend so far has been any indication, it is to be vigilant about ISC details moving forward across the board.

And, finally, we need more details from governments on what they expect to see for ISCs. Both jurisdictions need to provide guidance on the evidence required for determining the fair market value of shares to determine if a shareholder holds a "significant number of shares". Also, a warning or caution would be helpful to note ISCs of a trust may not be the same depending on the jurisdiction in which the trust is filing. Federally, it would be helpful to understand if Corporations Canada intends for the ISC test to be different than the trust's "central management and control." Provincially, if the OBCA is to continue prohibiting trustees and other legal representatives to be listed as ISCs, some confirmation or notation on their website is necessary to warn corporations and shareholders alike that ISCs may not match income tax or other legal positions taken. Clarity around whether other connected individuals, like a protector or settlor, could be listed as ISCs for OBCA corporations would also be helpful.

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[1] *Canada Business Corporations Act*, RSC 1985, c C-44, s. 21.1(1) (CBCA).
[2] *CBCA*, s. 21.1(2).
[3] *CBCA*, s.2.1(3).
[4] Corporations Canada: https://ised-isde.canada.ca/site/corporations-canada/en/individuals-significant-control
[5] *CBCA*, s.21.1(6).
[6] *Canada Business Corporations Regulations, 2001*, SOR/2001-512, s. 33(1).
[7] *CBCA*, s.21.4(5).
[8] *CBCA*, s.2.1(1)(a).
[9] *Ibid*, note 4.
[10] *Fundy Settlement v. Canada*, 2012 SCC 14 at para 15 (Fundy).
[11] *CBCA*, s.21.31(2).
[12] *Fundy* at para 7.
[13] *CBCA*, s.2(1); *Business Corporations Act* (Ontario), R.S.O. 1990, c. B. 16 (OBCA), s.1(1).

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