CANADIAN UPDATE ON CROSS-BORDER TAX PLANNING

Over the last two years, as tax rates in jurisdictions like the United States have fallen, Canada's personal and corporate tax rates continue to be calcified at the high end, internationally. In Ontario, the top personal marginal rate is 53.53%. The general corporate tax rate is 26.5% and the tax rate on investment income of a Canadian-controlled private corporation is 50.2%. Rather than looking forward to reduced exposure to high taxes, Canadians are facing exposure to the indiscriminate exchange of information, both domestically and internationally, with virtually no protections for privacy rights.

Canada is enacting the new international tax regime rules promulgated by the OECD under the Base Erosion and Profit Shifting Project ("**BEPS**"). The Income Tax Act (Canada)(the "**ITA**") has been amended to promote transparency through the automatic exchange of information known as the Common Reporting Standard ("**CRS**"). This prescription for combatting tax evasion and aggressive tax avoidance reflects a shift from mere legal ownership of financial assets to beneficial ownership.

This exchange of information is heavily influenced by FATCA (U.S. "Foreign Account Tax Compliance Act") and the resulting Canada/US Intergovernmental Agreement. However, unlike FATCA which has heavy sanctions through the imposition of 30% withholding tax, CRS has no sanctions; it relies on intergovernmental peer pressure. The only sanction under the ITA for failure to provide a tax identification number to the financial institution collecting the information from account holders is a fine of CAD $500.00.

Canadian financial institutions must collect information about financial accounts owned by residents of other countries ("Reportable Persons"), and must report this information to the Canada Revenue Agency (the "**CRA**"). In turn, the CRA will transmit this information to the taxation authority of the country of residence of the account holder. The other countries that implement the CRS will likewise require their financial institutions to collect information about Canadians that will be transferred to the CRA.

Only financial accounts are reportable under CRS, whereas under a Tax Information Exchange Agreement ("**TIEA**"), information can be requested that encompasses all tax-related assets (e.g. real estate). A "Financial Account" is not a legal document, such as a Deed of Trust or an Agreement; thus, there is no authority under CRS to require disclosure of same. Accordingly, it is apparent that CRS is primarily an instrument of deterrence (in response to public outrage over disclosures in the Panama Papers, the Paradise Papers, etc.), accompanied by erosion of privacy rights, whereas the TIEA is the central instrument for tax authorities to conduct international tax investigations with tax havens.[1]

There have been some concerns raised in Canada and elsewhere over the erosion of privacy rights, given that there is no requirement for due process, e.g. there is no requirement to inform the account holder that this information is being transmitted to the country of residence, and no right to make representations against such a transmission. If an account holder comes from a corrupt country, such information may be used to blackmail, kidnap or otherwise harm the family or their business.

"Reporting Financial Institution" covers depository institutions, investment entities and specified insurance companies. "Reportable Accounts" include financial accounts held by individuals and entities, including a non-financial entity that requires a high level of due diligence to determine if a Reportable Person is in control. In the case of a Corporation, 25% share ownership is enough to constitute control. In the case of a Trust, this could be the Settlor, the Trustee, a Beneficiary, a Protector, or any other person exercising effective control over the Trust

How a Beneficiary can be a controlling person of a Trust is not only mystifying but is contrary to law and historical experience.

The following commentary by the OECD in its 2014 seminal publication, "Standard for Automatic Exchange of Financial Account Information in Tax Matters", at page 12, shows the extreme, almost paranoid, breadth of disclosure required:

> "A comprehensive reporting regime requires reporting not only with respect to individuals, but should also limit the opportunities for taxpayers to circumvent reporting by using interposed legal entities of arrangements. This means requiring financial institutions to look through shell companies, trusts or similar arrangements, including taxable entities to cover situations where a taxpayer seek to hide the principal but is willing to pay tax on the income."

[1] Currently, Canada has 93 Tax Treaties with other comparable jurisdictions, and 24 TIEA's with low-tax jurisdictions around the world.

What this excerpt reveals is that the true purpose of BEPS is not to prevent tax evasion but to introduce into the worldwide tax regulatory system a means for anti-money laundering inquiries to have access to beneficial ownership of entities. Clearly, a global system for combatting terrorist financing and drug-money laundering is laudable, but this should not be done at the cost of perverting the income tax system. In order to preserve an income tax system based on voluntary disclosure and compliance, there has always been a protection of privacy rights. If this protection is now eroded because of the misuse of the income tax reporting requirements, the integrity of our worldwide income tax systems is put at serious risk.

Country-by-Country Reporting ("**CbC**") is another OECD initiative to combat tax avoidance and tax evasion by multinational corporations and to promote transparency and ease of administration. Canada has implemented CbC reporting in the ITA. An MNE with total consolidated group revenue of €750,000,000 or USD$838,500,000 must file CbC reports.

A CbC report includes global allocation, by jurisdiction, of key variables for the group, including: revenue, profit, tax paid, stated capital, accumulated earnings, number of employees and tangible assets, as well as the main activities of each constituent entity. Ostensibly, this tool is used to assess high level transfer pricing risk; to assess other BEPS-related risks; and for economic and statistical analysis.

Theoretically, CbC reporting can provide a risk assessment tool than call allow for deselecting low risk taxpayers, but practical experience with CRA auditors that overburden taxpayers belies that likelihood.

This is illustrated in the case of *BP Canada Energy Company (Appellant) v. Minister of National Revenue (Respondent) and Chartered Professional Accountants of Canada (Intervener),* [2] where tax accrual working papers of a company were demanded by a CRA auditor even though these were not material to the current tax audit, but they might be in the future.

The Federal Court of Appeal turned it down as an improper use of a powerful tool requiring information disclosure under the ITA.

CbC reports filed with the CRA will be automatically exchanged with other jurisdictions in which the MNE operates, and *vice versa*. Critics have expressed concern over the clamour for

[2] 2017 DTC 5028 (Federal Court of Appeal of Canada)

public disclosure of such information that competitors could use against the interests of the disclosing corporation. This is another example of the erosion of confidentiality in the income tax system and increased risk of non-compliance.

Following the OECD lead to enhance transparency and the automatic exchange of information, the ITA is being amended to require **trusts** to disclose information ostensibly to combat tax evasion and aggressive tax avoidance. Starting in 2021, most express, residence trusts and non-resident trusts that are required to file a tax return, with assets worth at least CAD$50,000, must report certain personal information in the T3 Annual Tax Return.

The following personal information must be reported: Settlor, Trustees, Beneficiaries, Protectors, and any other person who has the ability to exert influence over the Trustee's decisions regarding the distribution of income or capital of the trust. The same criticism applies here in the domestic context as was noted earlier in the international context.

The following gross negligence penalties apply for knowingly contravening the filing requirements: the greater of $2,500, and 5% of the highest amount at any time in the year that is the total fair market value of all the property held by the trust- resulting in a draconian penalty regime.

Canada is following the lead of the OECD and enacting **business corporate laws** to require transparency and the automatic exchange of information. The stated purpose is to prevent corporations from being misused for tax evasion, money laundering, corruption and financing of terrorist activities. Starting July 1, 2019, each private corporation incorporated under the *Canada Business Corporations Act* (the "**CBCA**") will be required to maintain a register of "individuals with significant control of the corporation".

Who are "individuals with significant control of the corporation"?

- An individual who is the 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 the corporation's shares, or 25% or more of the corporation's shares measured by fair market value, or
- An individual who has direct or indirect influence that, if exercised, would result in control in fact of the corporation.

What is in the Register and who has access to it ?

- The corporation must maintain information on its controlling person, including: name, date of birth, last known address, day on which individual became or ceased to be a controlling person, description of the controlling person's interests in the corporation and rights in respect of the corporation's shares, and jurisdiction of residence for tax purposes
- Access can be requested by the Director appointed by the Minister of Industry under the CBCA, any shareholder or creditor, so long as they are to use the information in connection with any matter relating to the affairs of the corporation.

What enforcement powers are there ?

- Any person who knowingly contravenes the new rules could be fined an amount not exceeding CAD$200,000 or six months imprisonment or both- which can imposed on the corporation, its directors, officers or shareholders.

What protections for privacy are there ?

- There is no right for a controlling person to be notified that a creditor or other person has been granted access to the Register,
- There is no right to challenge the release of information, e.g. Minister of National Revenue could be a creditor seeking personal information that could then be automatically sent to the taxation authority of the controlling person's jurisdiction of residence;
- Moreover, proposed amendments to the CBCA would expand the parties who have access to the Register to include certain investigative bodies (yet to be defined);
- In contrast, however, the corporation must prepare and maintain the Register by safeguarding personal information in accordance with the *Personal Information Protection and Electronic Documents Act* (Canada), which also mandates the corporation to obtain the consent of a person whose personal information is gathered, stored and shared. It is far from clear how a corporation can comply with these apparently conflicting obligations.

Governments in Canada (and around the world) are aggressively gathering personal information about individuals and certain corporations and automatically transmitting it to other governmental authorities, with virtually no protection for privacy rights.

In contrast, the Canadian Courts are developing new protections for individuals who are harmed through the broadcast of personal information through social media.

In the case of *Jane Doe 72511 v. N.M. et al.*[3] , a spurned lover posted nude pictures of his former girlfriend on a pornographic site; she sued him and won on the basis of the new tort of public disclosure of private facts. The plaintiff successfully proved the following elements of the tort:

- The defendant publicized an aspect of the plaintiff's private life,
- The plaintiff did not consent to the publication,
- The matter publicized would be highly offensive to a reasonable person, and
- The publication was not of legitimate concern to the public.

While it is not appropriate, or possible, to apply this new tort to the actions of governments pursuant to sovereign Parliamentary legislation, the public needs to be aware of the full implications when successful companies and individuals are singled out for alleged misconduct, and these policies of transparency and automatic exchange of information put the privacy rights of all of us at risk.

There needs to be a public debate about the consequences of these policies that erode a fundamental Western value, especially when dealing with corrupt regimes outside Canada.

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[3] 2018 ONSC 6607 (Ontario Superior Court of Justice).