Cross-Border Giving Strategies and the New Disclosure Rules

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Topics to Discuss

1. Introduction:
2. Cross-Border Donations
3. Information Sharing, including CRS
4. Trust Tax Return Filings
5. Canada Business Corporations Act

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Cross-Border Donations

- Generally, Canadian resident can only get tax credit for individual or income deduction for corporation on donation to Canadian registered charity
- Exceptions:
  - Certain foreign universities qualify if registered with the CRA under the ITA
  - Article XXI-7 Canada-U.S. Tax Treaty permits recognition of Canadian resident donation to U.S. charity, provided donor has U.S.-source income
- Alternative: Canadian charity registered as "Canadian Friends of Charity X"

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Cross-Border Donations …cont'd

- Where a Canadian charity is registered as "Canadian Friends of Charity X", it may want to transfer funds from Canada to the non-resident Charity X
- The CRA prohibits the Canadian charity from being a mere conduit for such funds to be transferred to Charity X
- Instead, there must be a contractual arrangement made between the two organizations: typically a Joint Venture or an Agency Agreement, under which the Canadian charity must maintain sufficient direction and control to satisfy the CRA that it is not a conduit

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Cross-Border Donations …cont'd

- Cross-border giving is a complex area requiring careful navigation of the tax laws to ensure that tax deductions are maximized, permitting more to go to the charitable destination
- In a family business with international operations, it would be worthwhile to channel charitable donations to come from member companies in jurisdictions with the highest tax rates

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Cross-Border Donations …cont'd

- Compare private charitable foundation to donor-advised endowment fund with public charitable foundation
  - Confidentiality can be preserved only through a public foundation
  - Control can only be maintained through a private charitable foundation
  - For cross-border donation arrangements, public foundations may impose strict limits (country risk, for example), while a private family foundation may have more tolerance for such risks

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Common Reporting Standard

- The OECD has promulgated a process to combat tax secrecy and tax evasion, and to promote transparency through the automatic exchange of information known as the Common Reporting Standard ("CRS")
- Part XIX, Sections 270-281 have been added to the *Income Tax Act* to implement CRS in Canada
- Over 90 countries are committed to implementing CRS starting this year (except for the U.S.A.) by signing the OECD'S *Multilateral Convention on Mutual Administrative Assistance in Tax Matters*

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Common Reporting Standard...cont'd

- The OECD prescription for combatting Base Erosion and Profit Shifting is "Transparency and Automatic Exchange of Information"
- Reflects shift from mere legal ownership to beneficial ownership.
- Heavily influenced by FATCA (U.S. "Foreign Account Tax Compliance Act") and Canada/US Intergovernmental Agreement
- But unlike FATCA which has heavy sanctions through the imposition of 30% withholding tax, CRS has no sanctions
- Expect peer review to establish and maintain Standard

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Common Reporting Standard…cont'd

- The OECD proclaims that the following are the main benefits of automatic exchange of information ("AEOI"):
  - AEOI can provide timely information on non-compliance where tax has been evaded
  - It can help detect cases of non-compliance even where a tax administration has had no previous indication of non-compliance
  - It has deterrent effects, increasing voluntary compliance and encouraging taxpayers to report all relevant information
  - It can help educate taxpayers in their reporting obligations, increase tax revenues and, thus, lead to fairness – ensuring that all taxpayers pay their fair share of tax in the right place at the right time

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Common Reporting Standard…cont'd

- The Standard requires universal rules for Keeping Information, Collecting Information and Exchanging Information
- Governments in CRS jurisdictions have downloaded significant due diligence requirements on Financial Institutions in order to open and maintain Financial Accounts
- Controversy in some countries where there is pressure to make certain private records of beneficial ownership of companies and trusts publicly available

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Common Reporting Standard …cont'd

- Canadian financial institutions must collect information about financial accounts owned by residents of other countries (*Reportable Persons*), and must report this information to 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

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Common Reporting Standard …cont'd

- Only financial accounts are reportable under CRS, whereas under a Tax Information Exchange Agreement, 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.), whereas the TIEA is the central instrument for tax authorities to conduct international tax investigations with tax havens

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Common Reporting Standard …cont'd

- Concern over infringement on privacy rights with no requirement for due process, e.g. 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

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Common Reporting Standard ...cont'd

- *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 ("Passive NFE") 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

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Common Reporting Standard ...cont'd

- 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."

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Tax Reporting for Trusts

- Again, following the OECD lead to enhance transparency and the automatic exchange of information, the Income Tax Act (Canada) 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 $50,000, must report certain personal information in the T3 Annual Tax Return; exceptions include a graduated rate estate

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Tax Reporting for Trusts …cont'd

- The following personal information must be reported:
  - Settlor
  - Trustees
  - Beneficiaries
  - Protectors
  - 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

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Tax Reporting for Trusts …cont'd

- 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

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Canada Business Corporations Act

- Canada is following the lead of the OECD and enacting corporate laws to require transparency and the automatic exchange of information
- 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 CBCA will be required to maintain a register of "individuals with significant control of the corporation"

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Canada Business Corporations Act …cont'd

- 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

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Canada Business Corporations Act …cont'd

- What is in the Register and who has access to it ?
  - Corporation must maintain information on 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 under the CBCA, certain authorized investigative bodies (such as a police force), 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

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Canada Business Corporations Act …cont'd

- What enforcement powers are there ?

  - A corporation that without reasonable cause contravenes the new requirement is guilty of an offence and is liable for a fine not exceeding $5,000
  - Knowingly contravening the new rules could result in fines not exceeding $200,000 or six months imprisonment or both, imposed on the corporation, its directors, officers or shareholders

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Canada Business Corporations Act …cont'd

- What protections for privacy are there ?
  - No right for a controlling person to be notified that a person has been granted access to the Register
  - No right to challenge the release of information, e.g. Minister of National Revenue could be creditor seeking personal information that could then be automatically sent to the taxation authority of the controlling person's jurisdiction of residence
  - 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) ("PIPEDA")

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Canada Business Corporations Act …cont'd

- How does this disclosure of detailed personal information square with a CBCA corporation's obligations under PIPEDA ?
- Under PIPEDA, the corporation must adopt and implement adequate security safeguards to protect information from loss or unauthorized disclosure or access
- In addition, the corporation must obtain the informed consent of the affected beneficial owner to include his/her personal information in the Register

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Conclusions on Disclosure Today

- Governments in Canada (and around the world) are aggressively gathering personal information about individuals and automatically transmitting it to other governmental authorities, with virtually no protection for privacy rights
- In contrast, the Courts are developing new protections for individuals who are harmed through the broadcast of personal information through social media

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Conclusions on Disclosure Today …cont'd

- In the case of *Jane Doe 72511 v. N.M. et al.* , 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.

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Conclusions on Disclosure Today …cont'd

- While it is not appropriate, or possible, to apply this new tort to the actions of governments pursuant to 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, especially when dealing with corrupt regimes outside Canada

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Questions?

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