

CAUGHT IN THE SANCTIONS CROSSFIRE: CANADA'S PROPOSED NEW CONTROL TEST HAS BROAD REPERCUSSIONS ON BUSINESSES WITH ANY NEXUS TO RUSSIA

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The Canadian government is proposing significant changes to its economic sanctions laws. We discuss in this bulletin the adoption of a new test for "deemed ownership," as well as the increased convergence of sanctions and anti-money laundering ("AML") regulation.

Canadian businesses and citizens should pay careful attention to these changes if they or their business partners have ties with companies doing business, directly or indirectly, with Russian or other sanctioned parties.

Out of "Control": Broad and Uncertain New "Control" Threshold for Canadian Sanctions

Canada's economic sanctions regime prohibits various dealings with, including dealing in any property that is owned, held or controlled by, sanctioned persons.^[1] Unlike other allied jurisdictions, Canada has not provided a definition or official guidance concerning the interpretation of "ownership" and "control" in the sanctions context. Amendments in [Bill C-47](#), (the 2023 budget implementation Bill), will change that approach.

The draft legislation will deem a sanctioned person to "control" an entity if:

1. the person holds, directly or indirectly, 50% percent or more of the shares or ownership interests in the entity, or has more than 50% of the voting rights;
2. the person is able, directly or indirectly, to change the composition or powers of that entity's board of directors; or
3. it is reasonable to conclude that the person is able to direct the entity's activities, either directly or indirectly.^[2]

The implication of a "control" relationship is that the company controlled by a sanctioned person is effectively treated as a sanctioned entity. This treatment is not controversial for majority-owned subsidiaries or joint ventures. However, the amendments will deem control to exist in a much broader range of circumstances.

We discuss each of these three tests in turn.

The 50% Test

Canadian businesses have found themselves at a disadvantage vis-à-vis their US and UK counterparts given the clearer nature of the control tests for sanctions in those jurisdictions. In the US, the Office of Foreign Assets and Control (“**OFAC**”) [50 Percent Rule](#) provides that entities that are owned 50% or more by one or more sanctioned persons are automatically considered to be blocked. In the UK, the Office of Financial Sanctions Implementation has a similar but not identical criterion: an entity is owned or controlled by another person when that person holds more than 50% of the shares or voting rights. This first branch of Canada’s control test uses a 50% or more definition that is consistent with the US approach, except that the Canadian test does not expressly address the possibility that multiple sanctioned persons may individually own less than 50% of an entity but may cumulatively surpass the 50% threshold.

The Board Composition or Powers Test

Canada’s proposed use of an alternative test that relates to ability to change the powers or the composition of a board will require complex further assessments of potential deemed “control” arrangements where a sanctioned person holds less than a 50% ownership interest.

In contrast to the US, the Canadian proposal significantly broadens the scope of deemed control to entities with only minor shareholdings by sanctioned individuals. In contrast to the UK, which considers holding of 50% of voting rights and the ability to “appoint or remove a majority of the board of directors” as indicators of control, Canada’s proposed definition does not require the ability to affect the majority of the board, but only change its composition or powers in some way.

The Canadian proposal is particularly concerning because of the inclusion of the “directly or indirectly” language and because it will be difficult if not impossible for third parties to ascertain whether a sanctioned entity may have some ability to affect board powers or composition. For example, in many private companies, shareholders will have a right to nominate a director. This would not constitute control of the entity in any normal usage of that concept, but would be deemed to be control regardless of the size of the board.

The Ability to Direct Activities Test

The third branch of the deemed control test is similarly problematic. There are broad “directly or indirectly” references and it is not clear which “activities” would be sufficient to engage this test. The legislation appears to be employing an objective standard (“reasonable to conclude”) rather than a subjective standard of the third party’s actual knowledge. However, it is unclear how the reasonableness standard would be applied to a third party that has no access to confidential information about the sanctioned person and his/her/its relationship

with separate entity in which it owns some unspecified minority equity interest.

Compliance

Businesses and individuals that are subject to Canadian sanctions laws may need to re-assess their dealings with entities associated in some way with sanctioned persons, even where ownership levels are very low.

Bill C-47 introduces numerous other proposed changes to Canadian sanctions provisions. McMillan's international trade team remains available to provide guidance on these potential amendments. Importantly, none of the changes discussed above are final; they are subject to debate and may be modified in the coming weeks as the legislation is considered by Parliament.

AML and Sanctions Regulation Converge

Canadian businesses, and especially those in the financial sector, should also recognize the increasing convergence between Canada's AML and sanctions regimes.

For example, Canada's [2023 Budget](#) highlights that the G7+ Russian Elites, Proxies and Oligarchs ("**REPO**") Task Force's collective efforts have resulted in the freezing or blocking of more than \$58 billion worth of assets.^[3] Despite this significant impact, the REPO Task Force notes that sanctioned Russians have managed to evade sanctions and have maintained access to funds, generated additional revenue, or procured export-controlled and sanctioned items.^[4] This often occurs through, for example, the use of family members and close associates to ensure continued access and control; use of real estate; use of complex ownership structures; and the use of third party jurisdictions to facilitate shipment of sensitive goods to Russia.

Many of these sanctions evasions patterns are known money-laundering typologies.

In apparent recognition of this growing overlap between sanctions and AML, Canada's 2023 Budget indicates that the federal government intends to set up obligations for the financial sector to report sanctions-related information to FINTRAC, Canada's financial intelligence unit. Currently under Canadian sanctions laws, financial institutions must report to either the Royal Canadian Mounted Police ("**RCMP**") or Canadian Security Intelligence Services ("**CSIS**") and to their financial services regulator. Further, Bill C-47 provides the Minister of Foreign Affairs with the authority to disclose to FINTRAC any information that is relevant to making or enforcing Canadian sanctions orders.^[5]

Budget 2023 also confirms the government's commitment to establishing a publically accessible federal beneficial ownership registry as a tool to combat both sanctions evasion and money laundering. Currently, privately held corporations incorporated or continued under the *Canada Business Corporations Act* must maintain a register of certain information about "beneficial owners", which generally means individuals with

“significant control” of the corporation (which, in turn, generally means individuals with at least 25% of the votes or value of all the corporation’s shares).[6] Changes were introduced last year that would, once in force, require corporations to report beneficial ownership information annually to Corporations Canada.[7] In addition, [Bill C-42](#) proposes an amendment that would require Corporations Canada to make certain information relating to beneficial ownership public,[8] in line with actions taken by other jurisdictions, including the UK.[9] The federal government has committed to implementing this registry by the end of 2023.

Companies should ensure that their AML and sanctions compliance programs are aligned, and that they accurately identify high-risk entities and transactions. Companies may also need to review and revise their due diligence processes to better identify beneficial owners, given the increased focus on this aspect of compliance.

Previous Bulletins Published Since Russia’s Further Invasion of Ukraine in 2022

This is McMillan’s ninth bulletin on sanctions since Russia’s further invasion of Ukraine in 2022.[10] Our sanctions and international trade team continues to assist clients with compliance and informs them of trends and developments in sanctions and AML compliance. We will continue to do so as the landscape continues to evolve.

Please reach out to learn how the changing laws and regulations will affect your business.

[1] Specifically, the *Special Economic Measures Act*, SC 1992, c 17, and the *Justice for Victims of Corrupt Foreign Officials Act (Sergei Magnitsky Law)*, SC 2017, c 21.

[2] Bill C-47, An Act to implement certain provisions of the budget tabled in Parliament on March 28, 2023, 1st Sess., 44th Parl, 2023, s. 253.

[3] Budget 2023, [A Made-In-Canada Plan](#) (March 2023), p. 167.

[4] Department of Finance Canada, [Global Advisory on Russian Sanctions Evasion Issued Jointly by the Multilateral REPO Task Force](#), March 9, 2023.

[5] Specifically, the Minister of Foreign Affairs may report to FINTRAC information relevant to making or enforcing an order relating to restricted and prohibited activities, as well as orders relating to the seizure and restraint of property, under the *Special Economic Measures Act* and the *Justice for Victims of Corrupt Foreign Officials Act (Sergei Magnitsky Law)*.

[6] *Canada Business Corporations Act*, RSC, 1985, c. C-44, s. 2.1 and 21.1.

[7] Bill C-19, An Act to implement certain provisions of the budget tabled in Parliament on April 7, 2022 and other measures, 1st Sess., 44th Parl., 2022, s. 431.

[8] Bill C-42, An Act to amend the *Canada Business Corporations Act* and to make consequential and related amendments to other Acts, 1st Sess., 44th Parl., 2023, s. 4.

[9] In an effort to combat money laundering and sanctions evasion, the UK set up a register of overseas entities that are required to disclose, and keep updated, information about their beneficial owners under the *Economic Crime (Transparency and Enforcement) Act, 2022*. This register came into force in August 2022 and applicable entities were required to register by January 2023. (For our previous bulletin on the potential impact of this Act on Canadian businesses, see [here](#)). The UK has also established a [Register of People with Significant Control](#).

[10] See:

- [Canada Strengthens Its Economic Sanctions and Export Controls Against Russia and Supports Russia's Removal from SWIFT](#) (February 25, 2022);
- [Canada Ratchets Up its Sanctions in Response to the Russia-Ukraine Crisis](#) (March 4, 2022);
- [Canada Further Expands its Sanctions Regime Against Russia](#) (March 29, 2022);
- [Canada Expands Sanctions on Russia and Proposes Broad Legislative Changes to its Sanctions Regime](#) (June 1, 2022);
- [Canada Clamps Down on Services Provided to Russia](#) (June 13, 2022);
- [Services, Sensitive Technologies, Luxury Goods, Gold and Disinformation Sanctions – Plus a Forfeiture Regimes: Canada's Latest Responses to the Russian Invasion of Ukraine](#) (July 13, 2022);
- [Canadian Sanctions Revisited: More Russian and New Iranian Sanctions, Including Price Cap on Russian Oil](#) (October 4, 2022);
- [Sanctions Pivot: Canada Seeks Forfeiture of Russian-Owned Assets to Fund Reconstruction of Ukraine and Adds Oil Price-Cap Restrictions](#) (December 22, 2022)
- [One Year On: Economic Sanctions Have Become a Primary Tool of Canadian Foreign Policy and New Russian Sanctions are Imposed](#) (March 1, 2023)

by [William Pellerin](#), [Neil Campbell](#) and [Tayler Farrell](#)

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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