Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

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RBC DS Declaration of Trust accounts (for common law jurisdictions)

RBC DS Trust Agreement accounts (for common law jurisdictions or Quebec)

Enhanced trust reporting requirements beginning in 2023

As part of your financial arrangements with RBC Wealth Management, you may have opened an account using the RBC Dominion Securities (DS) Declaration of Trust in common law jurisdictions, or RBC DS Trust Agreement in common law jurisdictions or Quebec. For the purpose of this article, both agreements are referred to as the DS Trust Agreement. This account is also sometimes referred to as the “DS Formal Trust Account”. It’s important to note that by signing the DS Trust Agreement, you created an irrevocable formal trust and you should be aware of the tax reporting and legal obligations associated with a formal trust.

The trust and all transfers made to it are irrevocable. This means any gifts or transfers of assets to the trust cannot be recovered by you, the settlor, or any other contributor/donor (if different than you). There are a number of versions of the DS Trust Agreement. Most versions of the DS Trust Agreement provide the trustee with absolute discretion to pay out any or all of the income or capital of the trust to any one of the named beneficiaries, to the exclusion of all others. Information on what a trust is, how it’s created, and the parties to a trust can be found in the Appendix to this article.

This article highlights key information regarding enhanced reporting and compliance requirements for trusts that may apply to your trust. Due to the government's move towards increased disclosure for trusts, as trustee you should prepare now to meet these new obligations. It's important you understand the terms in the signed DS Trust Agreement, a copy of which is available from your RBC advisor. You should consult with a qualified tax and/or legal advisor to discuss your particular circumstances and how best to prepare for the enhanced reporting obligations.

Trust reporting requirements

Current trust reporting requirements

For Canadian income tax purposes, a trust is treated as a separate taxpayer, distinct from the settlor and beneficiary. Under the Income Tax Act (ITA), as well as the Canada Revenue Agency's (CRA's) current administrative position, a trust needs to file a T3 return if the trust has tax payable, has a taxable capital gain, is requested to file, or holds property that's subject to subsection 75(2) of the ITA (the "super attribution" rules, discussed later). A trust will also be required to file a T3 return in a year if it receives income or capital gains from the trust property that's allocated to one or more beneficiaries, and the trust has:

- Total income from all sources of more than $500;
- Income of more than $100 allocated to any single beneficiary;
- Made a distribution of capital to one or more beneficiaries; or
- Allocated any portion of the income to a non-resident beneficiary.

Note that this is not an exhaustive list.

The super attribution rules generally apply where the person who transfers property to the trust (e.g. the settlor or contributor to the trust) retains control over the property or where the property can revert back to the settlor or contributor. An example of a situation where this may occur is where the settlor is the sole trustee or the controlling trustee of the trust (e.g. one of two trustees).

Generally speaking, under current CRA filing requirements, many trusts established using the DS Trust Agreement have an annual T3 return filing obligation.

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Canadian government enhancing trust reporting requirements beginning in 2023

The Canadian government and many governments around the world have been stepping up disclosure requirements in order to determine taxpayers' tax liabilities and to effectively counter aggressive tax avoidance. As part of these efforts, the Canadian government has introduced enhanced income tax reporting requirements for certain trusts. These new trust reporting rules were included as part of Bill C-32, which received Royal Assent on December 15, 2022. The new measures will apply to certain trusts for taxation years that end after December 30, 2023.

All inter vivos trusts, including a trust created with the DS Trust Agreement, have a December 31 year-end and therefore these rules will apply for the 2023 taxation year.

The new reporting requirements will have the following effect:

- Trusts that have a T3 return filing requirement under the original rules (previously discussed) will be required to disclose significant additional information on the T3 return, unless they meet an exception; and
- The number of trusts required to file a T3 return will be expanded to include many trusts that would otherwise not have previously been required to file.

Under the new enhanced rules, an "express trust" that is resident in Canada, for a taxation year that ends after December 30, 2023, will be required to file a tax return, unless it meets certain exceptions. An express trust is generally understood to be a trust that's deliberately created by a settlor. A non-express trust is a trust that's imposed or created by courts, such as a resulting trust or a constructive trust.

An exception to the new enhanced disclosure rules is for a trust that holds assets with a total fair market value (FMV) that doesn't exceed $50,000 throughout the year, if the only assets held by the trust throughout the year are one or more of the following: cash; certain government debt obligations; a share, debt obligation or right listed on a designated stock exchange; mutual fund corporation shares or trust units; or an interest in a related segregated fund. Note that this list doesn't include private company shares or real estate.

Even if a trust is exempt from the reporting obligations under the new rules, a T3 return will still need to be filed if it's required to do so under any other rules as discussed previously.

These new measures will increase the amount of information that needs to be included when a trust tax return is filed. Under the original rules, only a limited amount of information with respect to the parties to the trust has to be disclosed on the T3 return. The new measures increase the amount of information that needs to be included when a T3 return is filed. When a trustee files a T3 return, they will be required to provide the identity and specific information for each person who is settlor, trustee, beneficiary, or has the ability through the terms of the trust or a related agreement to exert influence over trustee decisions regarding the appointment of income or capital of the trust (i.e. a protector of a trust). The new reporting requirements will place a heavier burden on a trustee to gather and report this information.

Under the new measures, a trustee who fails to file a T3 return to comply with the new expanded reporting requirements, or who makes a false statement or omission on the trust tax return knowingly, or in circumstances that amount to gross negligence, will be subject to a penalty. This penalty will also apply where a trustee fails to comply with a demand by the CRA to file a trust tax return. The new penalty will be equal to the greater of $2,500 or 5% of the highest total FMV of all of the property held by the trust for the year. The penalty may be quite substantial if the trust holds assets of significant value. With the potential penalties in mind, you should review your DS Trust Agreement with a qualified tax and/or legal advisor and discuss next steps to prepare for the new reporting obligations.

Taxation of income and capital gains earned in your trust, where the super attribution rules apply

If the super attribution rules apply, all income/losses and capital gains/losses earned in the trust are attributed back to the settlor or contributor and taxed in their hands at their marginal tax rate. It's the CRA's administrative position, however, that a T3 return still must be filed. If the intention of setting up the trust is to achieve income splitting, the application of the super attribution rules has the result of defeating any income splitting opportunity.

Taxation of income and capital gains earned in your trust, where the super attribution rules do not apply

Income and capital gains earned but not paid or made payable to the beneficiaries

In general, all income and capital gains earned on the trust's capital for the year is taxable in the trust. A trust can claim a deduction for any income or capital gains that have been paid or made payable to a beneficiary of the trust during the year. Any income or capital gains earned in the trust and not paid or made payable to a beneficiary are taxed in the trust at the top individual marginal tax rate for the trust's province or territory of residence. The trust is not entitled to claim a personal tax credit.

As trustee, you should seek advice from a qualified tax and legal advisor as to your ability to make income and capital gains paid or payable to a beneficiary of the trust, as well as the steps you need to take to do so, in accordance with the trust terms.

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Income or capital gains paid or made payable to a beneficiary

Subject to the attribution rules, income or capital gains paid or made payable to or used for the support or benefit of a Canadian resident beneficiary are included in the beneficiary's tax return and subject to tax at the beneficiary's marginal tax rate in their province or territory of residence.

The attribution rules

You can only make irrevocable gifts to a trust established using the DS Trust Agreement. The attribution rules apply where you, the contributor, make a gift to a trust, and income and capital gains earned on that property is allocated to your spouse, as beneficiary. In such a case, the income and capital gains will be attributed back to you and taxed in your hands at your marginal tax rate.

The attribution rules also apply where you, the contributor, make a gift to a trust, and income is allocated to a non-arm's length minor beneficiary, such as a child, grandchild, niece or nephew. In such a case, the income will be attributed back to you and taxed in your hands at your marginal tax rate. Any capital gains that are allocated to the non-arm's length minor beneficiary, however, can be taxed in their hands.

As a result of the attribution rules, the income splitting benefits of a trust established using the DS Trust Agreement may be limited where it's set up for the benefit of a spouse or a non-arm's length minor beneficiary.

Winding up your trust

In light of the upcoming tax changes, you may be interested in winding up your trust established using the DS Trust Agreement. It's important to note that if your named beneficiary is a minor, distributions from the account cannot be made directly to them (as a minor beneficiary cannot provide a valid discharge to the trustee to relieve them of personal liability). You should review the DS Trust Agreement with a qualified legal advisor to determine when and how the trust can be wound up.

From an income tax perspective, distributions of income will be taxable in the beneficiary's hands, subject to the attribution and super attribution rules. If the trustee makes a distribution of capital to a beneficiary, the assets can be received by the beneficiary tax-free. As trustee, you can choose to make the capital distribution in cash or in-kind. From an income tax perspective, assuming the trust is a tax resident of Canada, if you make the distribution in-kind to a Canadian resident beneficiary, this can generally be done on a tax-deferred basis unless the super attribution rules apply. If the super attribution rules apply, the capital will generally need to be distributed to a beneficiary at FMV, unless the beneficiary is the contributor to the trust or the contributor's spouse, or if the contributor has passed away. Capital distributions to a non-resident beneficiary must also be done at FMV, triggering a taxable disposition in the trust.

Obtaining a CRA trust account number

In addition to the enhanced reporting rules for trusts, the CRA requires financial institutions to collect additional information for trusts and other entity accounts. Financial institutions are required by the CRA to request trust account numbers for existing DS Trust Agreement accounts. The CRA may apply a penalty to the trustee of $100 if the trustee fails to provide a valid trust account number to the financial institution and tax slips are issued to the trust without a trust number. This penalty may not be imposed in certain circumstances, including where an application for a number is made to the CRA within 15 days after receiving the financial institution's request and the number is provided to the financial institution within 15 days after its receipt by the trustee.

The CRA will issue a trust account number, if the trust does not already have one, when the first T3 trust return is filed (if paper filing). The CRA will show the trust account number assigned on the T3 Notice of Assessment for the trust.

The trustee may choose to apply for a trust account number before filing the first tax return. It's important to seek advice from a qualified tax and/or legal advisor before filing a T3 trust return or applying for a trust account number, especially in the case where previous filing requirements have not been met.

From an income tax perspective, distributions of income will be taxable in the beneficiary's hands, subject to the attribution and super attribution rules.

Next steps

Given the upcoming increased trust reporting and compliance requirements, you may wish to review your DS Trust Agreement with a qualified tax and/or legal advisor and discuss next steps to prepare for the new reporting obligations.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.

Appendix

What is a trust?

A trust is not a separate legal entity like a corporation, although it's treated as a separate taxpayer for tax purposes. A trust is a legal arrangement or relationship. An individual, known as the "settlor," creates a trust by entrusting some or all of their property to a trustee of their choosing. The trustee holds legal title to the trust property for the benefit of one or more individuals (the beneficiary or beneficiaries), specified by the settlor. The trustee owes a fiduciary duty to the beneficiary. This means they're required to act in the best interest of the beneficiary, who is the beneficial owner of the trust property. The trustee must administer the trust in accordance with the terms of the trust agreement and the laws that govern the trust.

A trust can be created during the lifetime of the settlor (known as an inter-vivos or living trust) or on their death (known as a testamentary trust). In general, a trust will come into existence with the transfer of at least one asset to the trustee.

For a trust to be valid, three certainties must be met:

1. Certainty of intention – there should be a clear intention to create a trust by the settlor;
2. Certainty of property – there must be certainty as to what property is being held upon trust and the beneficial interests in the trust property must also be certain; and
3. Certainty of beneficiary – the beneficiary of the trust must be clearly identifiable by name or class.

Under the Civil Code of Quebec, a trust is created by the transfer of property from the settlor of the trust to the trustee. The trust constitutes a distinct patrimony.

Although a trust can be created informally (in common law jurisdictions), as demonstrated by the actions of the parties to the trust, it is generally preferable to formally establish a trust by signing a legal document referred to as a trust agreement. Increasing "Know Your Client" regulatory requirements means financial institutions are moving away from informal trusts, and a trust agreement helps ensure the parties to and terms of the trust are known. The trust agreement indicates the settlor, trustee, beneficiary or beneficiaries, the powers and restrictions placed on the trustee, and how and when income and capital are to be distributed to a beneficiary and to which beneficiary. By formally documenting the parties to and terms of the trust, the potential for mismanagement of the trust assets or misinterpretation of the trust terms is reduced.

Parties to a trust

Settlor

A settlor is the person who creates the trust by transferring property to a trustee to be held and administered for the benefit of the beneficiary.

Contributor

A contributor is a person who transfers property to a trust for the benefit of the beneficiary. Often, the settlor is a contributor to the trust; however, a third party can also be a contributor.

Trustee

A trustee is a person or trust company appointed to administer property entrusted to them for the benefit of the beneficiary. A trustee's responsibilities are governed by the terms of the trust agreement and laws of the jurisdiction that govern the trust. Typical obligations include:

- Carrying out the express terms of the trust arrangement;
- Prudently investing the trust assets;
- Remaining impartial among beneficiaries;
- Accounting for their actions and keeping the beneficiaries informed about the trust; and
- Administering the trust in the best interest of the beneficiaries.

Beneficiary

A beneficiary is a person entitled to the use and enjoyment of the trust property. A beneficiary might be entitled to the income of the trust, capital of the trust or both.

Overlapping roles

While the roles of the settlor, contributor, trustee and beneficiary are all different, the people acting in these capacities can overlap. For example, in general, the settlor of the trust can also be a trustee and/or a beneficiary of a trust. Note that in Quebec, a settlor or beneficiary cannot be a sole trustee.

Some combinations of overlapping roles can have tax or legal implications. For example, the super attribution rules, discussed in this article, may apply where the settlor or contributor is the sole trustee of the trust, one of two trustees, or a capital beneficiary of the trust. Also, while a trustee can be a beneficiary of a trust, they may want to take extra care to ensure they are fulfilling their fiduciary duties and acting in the best interest of all beneficiaries of the trust.