Wealth Management

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INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

Changes to trust reporting requirements

Understanding the new changes

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Are you an executor or a trustee, including a bare trustee? If so, you should be aware that the reporting requirements for certain trusts are changing. As part of the 2018 federal budget, the government proposed changes to reporting requirements for trusts. Draft legislative proposals were originally released in July 2018 for consultation, and these proposed reporting requirements were to apply to certain trusts for taxation years that ended after December 30, 2021. Since that time, three versions of draft legislation were released and the implementation of these new trust reporting rules was delayed. On December 15, 2022, Bill C-32, which included the most recent draft of the trust reporting rules, received Royal Assent and is now law. The new trust reporting requirements will apply to trusts with a taxation year ending after December 30, 2023. Since most trusts have December 31 taxation year-ends, the trusts that are required to comply with these new requirements will need to do so for the 2023 tax year and onwards.

In accordance with these new measures, certain trusts that were not required to do so in the past may need to now file annual tax returns and provide additional beneficial ownership information for 2023 and subsequent tax years.

Filing a trust tax return

A trust needs to file a tax return (*T3 Trust Income Tax and Information Return*, also known as a T3 return) in certain circumstances. For example, a trust will be required to file a tax return if income from the trust property is subject to tax and, in a tax year, the trust has tax payable, is requested to file, has disposed of (or is deemed to have disposed of) a capital property, or holds property that's subject to subsection 75(2) of the Income Tax Act (the "super attribution" rules). A trust will also be required to file a tax 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.

A T3 return is viewed by the Canada Revenue Agency (CRA) as both an income tax return (which calculates tax liability) and an information return (which reports amounts allocated and designated to trust beneficiaries).

Based on the new measures, beginning in 2023, an “express trust” (or for civil law purposes, a trust other than a trust that’s established by law or by judgment) resident in Canada or deemed to be resident in Canada will be required to file a tax return, unless it meets certain exceptions, discussed later.

While the phrase “express trust” isn’t defined in the legislation or anywhere else in the Income Tax Act, it’s generally understood to be a trust that’s deliberately created by a settlor or Will maker. A non-express trust is a trust that’s imposed or created by courts, such as a resulting trust or a constructive trust.

As a result of these changes, beginning in 2023, certain trusts that currently don’t have to file a tax return may be required to do so. An example of a trust that may not need to file a trust return under the old rules, but will need to file under the new measures, is a properly structured trust in which the only asset is a cottage used by the beneficiaries of the trust where no income is earned on the cottage. Another example is a properly structured trust that holds a deferred growth investment portfolio with a market value of more than $50,000 and where no income or capital gains have been realized in the year. This assumes none of the exceptions that follow apply to these trusts.

The new measures also provide that a trust considered to be acting as an agent for all of the beneficiaries under the trust, with respect to all dealings in all of the trust’s property, commonly known as a “bare trust,” will be subject to the new reporting requirements.

What are the exceptions?

Under these new measures, certain trusts will be excluded from the expanded reporting requirements, even if they otherwise have to file a tax return. Some of these trusts include the following:

A T3 return is viewed by the Canada Revenue Agency (CRA) as both an income tax return (which calculates tax liability) and an information return (which reports amounts allocated and designated to trust beneficiaries).

- A trust that has been in existence for less than three months at the end of the year;
- A trust that holds assets with a total fair market value 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 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 (and note that this list doesn’t include private company shares or real estate);
- A trust that qualifies as a registered charity or non-profit organization;
- A mutual fund or segregated fund trust;
- A trust, all of the units of which are listed on a designated stock exchange (i.e. an ETF structured as a trust);
- A graduated rate estate;
- A qualified disability trust;
- An employee life and health trust; and
- Registered plans (e.g. RRSP, RRIF, RDSP, RESP, RPP, PRPP, DPSP, TFSA or FHSA).

The new rules also exempt the disclosure of information that’s subject to solicitor-client privilege.

It’s important to note that even if a trust is exempt from the information reporting obligations under these new rules, a T3 return will still need to be filed if it’s required under any other rules as discussed previously.

Additional disclosure on trust tax return

Under the original rules, only a limited amount of information with respect to the parties to the trust has to be disclosed on the trust tax return. The new measures increase the amount of information that needs to be included when a trust tax return is filed. When a trustee files a trust tax return, they’ll need to include the name, address, date of birth (in the case of an individual other than a trust), jurisdiction of residence and taxpayer identification number for each person who, in the year:

- Is a trustee, beneficiary or settlor of the trust; 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).

For the purpose of the new rules, the definition of a settlor is expanded to include anyone who has loaned or transferred property to the trust, unless they were dealing with the trust at arm's length at that time and have made a commercial loan to the trust at a reasonable rate of interest or a transfer of property for fair market value consideration.

Information requirements

A trustee will be considered to have fulfilled the requirement of providing information about the trust beneficiaries if they've made reasonable effort to obtain information about each beneficiary whose identity is known or ascertainable. For those trust beneficiaries whose identity is not known or ascertainable, a trustee will be considered to have met this requirement if they provide sufficiently detailed information so it can be determined whether any particular person is a beneficiary of a trust.

An example of where a beneficiary of a trust may not be known or ascertainable is where the trust instrument provides for a class of beneficiaries that includes the settlor's children or grandchildren, or any future born children or grandchildren. In these circumstances, the trust reporting requirement will be met if the relevant information about all of the settlor's current children and grandchildren is included, as well as the details of the trust terms that extend the class of beneficiaries to any of the settlor's future children or grandchildren.

This new requirement to provide information about all beneficiaries, ascertained and unascertained, may make things more difficult for trustees to comply with their obligations.

Additional penalties for failing to file a return with the expanded disclosure information

Under the new measures, a trustee who fails to file a trust tax 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, which is in addition to penalties that already existed, will be equal to the greater of $2,500 or 5% of the highest total fair market value of all of the property held by the trust for the year. With this in mind, this penalty may be quite substantial if the trust holds assets of significant value.

Under the new measures, a trustee who fails to file a trust tax 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.

Québec trust reporting requirements

Revenu Québec will harmonize with the federal changes to the trust reporting rules and apply these new rules for taxation years ending after December 30, 2023. The only difference is the amount of the new penalty. If a trust fails to file a tax return with the additional information requested under the new rules, it is liable to a penalty of $1,000, and starting on the second day, an additional penalty of $100 per day until the tax return with the additional information is filed, to a maximum of $5,000.

Obtaining a CRA trust account number

The enhanced income tax reporting requirements for certain trusts are part of the Canadian government's increased efforts over the last number of years to determine taxpayers' tax liabilities and to effectively counter aggressive tax avoidance. In addition to these measures, the CRA requires financial institutions to collect additional information for trusts and other entity accounts. This includes trust account numbers for legal trusts. The CRA may apply a penalty to the trustee of $100 if the trustee fails to provide a valid trust account number to a financial institution and the financial institution issues tax slips to the trust without a trust account 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.

If a trust doesn't already have a trust account number, the CRA will issue one to the trust when the first T3 return for the trust is filed (if paper filing). The CRA will show the trust account number assigned on the T3 Notice of Assessment for the trust. A trustee may also choose to apply for a trust account number before filing its first T3 return.

It's important to note that a trustee will generally need to provide a financial institution with a trust account number when it's requested by them, regardless of whether a T3 return needs to be filed for the trust.

If an existing trust currently doesn't have a trust account number but should have one, it's important that the trustee seek advice from a qualified tax and/or legal advisor before filing a T3 return or applying for a trust account number.

Conclusion

As a result of these new measures, executors and trustees may face more onerous reporting requirements, and the information gathering requirements may also be increased. If you're an executor or trustee, you may want to review these new measures with a qualified legal and tax advisor to determine how they might impact the estate or trust under your administration and prepare for the potential implementation of these measures.

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Wealth Management

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