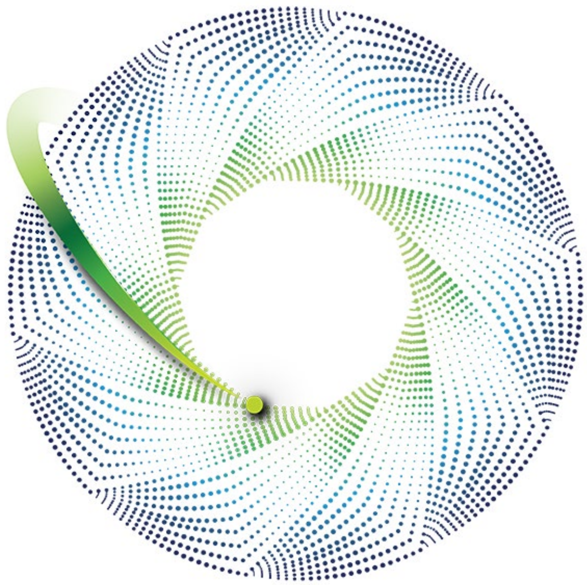

Canadian Tax & Legal Alert

Enhanced trust reporting rules: Broader impacts and what to do

October 31, 2023

Background

While trusts have always been required to file an annual income tax return, there have been several statutory and administrative exceptions to this filing requirement.

New legislation,[1] enacted late in 2022 and originally announced in Budget 2018, requires many trusts which are not currently filing income tax returns to file annual T3 income tax returns. Such trusts include internal or express trusts (e.g., endowment funds held by registered charities, "in trust for" accounts, trust accounts held for specific clients by professional services firms and bare trusts), subject to certain exceptions.

In addition to significantly broadening those included in the filing requirement, the legislation provides for enhanced reporting requirements for all trusts. The new reporting and disclosure rules will apply to taxation years that end after December 30, 2023. For most trusts, this means the reporting requirements will be in effect for the taxation year that ends on December 31, 2023, and subsequent taxation years. The first trust returns will be due March 30, 2024.

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[1] Bill C-32, An Act to implement certain provisions of the fall economic statement tabled in Parliament on November 3, 2022 and certain provisions of the budget tabled in Parliament on April 7, 2022, S.C. 2022, c. 19.

Potential Scope

As part of the new legislation, exceptions to the existing legislative requirement for trusts to file tax returns were modified under new subsection 150(1.2) of the Income Tax Act (Canada) (the "Act"). Subsection 150(1.2) of the Act provides that the existing exceptions under subsection 150(1.1) do not apply to an express trust resident in Canada unless the trust meets one of the specific exceptions listed in this subsection. While a review of what constitutes a trust is beyond the scope of this document, many trusts which have not previously had to file returns, will now have a filing requirement.

All affected trusts will be subject to the enhanced disclosure requirements in respect of trustees, beneficiaries, settlors, and each person who has the ability (through the trust terms or a related agreement) to exert influence over trustee decisions regarding the allocation of income or capital of the trust (e.g., a protector). Many bare trust corporations that are already filing an annual T2 corporate tax return will also be required to file an annual trust disclosure return in respect of the trust arrangement. In addition, any trust accounts established by lawyers for specific clients will be subject to these new rules. However, general law firm trust accounts are excluded.

The definition of "settlor" is broad for purposes of interpreting the reporting requirements and includes any non-arm's length person who has made a loan or transfer of property to the trust. Therefore, it will be very important to have a complete accounting of all the trust's transactions, including any expenses of the trust paid for by other persons, which may be in the form of loans.

In addition to the above, many family trusts, for example, have relied to date on the Canada Revenue Agency's (CRA) administrative exemption from filing where they have not earned any income or distributed any property to their beneficiaries. These trusts will now be required to file annually under the legislation.

How to Prepare? What information will need to be reported?

Many trusts have been filing T3 returns and the new legislation will simply mean enhanced disclosure requirements. For others (such as certain "in-trust for" accounts, bare trusts, and express trusts), the rules create a trust tax return filing requirement as well as disclosure requirements which are part of the tax return. Trust returns are prepared on a calendar year basis, which may require certain organizations with an off-calendar year end (common in the charitable sector, for example) to prepare trust financial records for these purposes based on a different reporting period.

All trusts will be required to provide additional information in respect of every settlor, trustee, and beneficiary, including:

- Name;
- Address;
- Date of birth (in the case of an individual other than a trust);
- Jurisdiction of residence; and
- Taxpayer identification number, such as social insurance number, trust account number, business number or taxpayer identification number used in a foreign jurisdiction.

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Non-compliance penalties

The legislation contains non-compliance penalties for incomplete or inaccurate information reported by trusts. These penalties can be summarized as follows:

- Failure to file: $25 for each day of delinquency with a minimum penalty of $100 and a maximum penalty of $2,500; and
- Knowingly making a false statement / gross negligence: greater of (a) $2,500, or (b) 5% of the highest amount of the fair market value, at any time in the year, of the trust assets.

The legislation provides that the disclosure obligations in respect of beneficiaries are met provided certain steps are undertaken. First, the trustee(s) must obtain the information required with respect to beneficiaries "whose identity is known or ascertainable with reasonable effort." If the identity of the beneficiary(ies) is not known with reasonable effort, then the trustee needs to disclose sufficiently detailed information that would describe a beneficiary, which would enable the CRA to determine if any particular person is a beneficiary of a trust.

For those beneficiaries whose identity is known, steps must then be taken to obtain the necessary information, including taxpayer identification numbers. Existing legislation states that a person requiring a taxpayer identification number of another person or partnership:

(a) Shall make a reasonable effort to obtain the number from the other person or partnership; and
(b) Shall not knowingly use, communicate or allow to be communicated, otherwise than as required or authorized under this Act or a regulation, the number without the written consent of the other person or partnership.

The CRA has published administrative guidance (IC 82-2R2) regarding what a "reasonable effort" consists of for certain tax reporting purposes and has indicated that:

> [Those responsible] should keep any documents they need to prove they made a reasonable effort to get [the personal information]. For example, when they send a request by mail, [the responsible person] should keep a record of the date of the request, an example of the request form, and the names of the people contacted […].[2]

Existing legislation imposes a penalty of $100 for each instance where information required for a return is not provided, including taxpayer identification numbers.

Excluded trusts

The legislation excludes the following trusts from these additional reporting requirements:

- Trusts that have been in existence for less than three months at the end of the year;
- Trusts that hold assets with a total fair market value that does not exceed $50,000 throughout the year, where the only assets held by the trust throughout the year include money, government debt obligations and certain listed securities;
- Trusts that are required under the relevant rules of professional conduct or the laws of Canada or a province to hold funds for the purposes of the activity that is regulated under those rules or laws, provided the trust is not maintained as a

[2] I*nformation Circular* 82-R2, "Social Insurance Number Legislation that Relates to the Preparation of Information Slips," November 20, 1992, at par. 10.

separate trust for a particular client or clients (this provides an exception for a lawyer's general trust account, but not for specific client accounts);

- Trusts that qualify as non-profit organizations or registered charities;
- Mutual fund trusts, segregated funds and master trusts;
- Trusts, all of the units of which are listed on a designated stock exchange;
- Graduated rate estates;
- Qualified disability trusts;
- Employee life and health trusts;
- Certain government funded trusts;
- Trusts under or governed by a deferred profit sharing plan, pooled registered pension plan, registered disability savings plan, registered education savings plan, registered pension plan, registered retirement income fund, registered retirement savings plan, tax-free savings account, employee profit sharing plan, registered supplementary unemployment benefit plan or first home savings account; and
- Cemetery care trusts and trusts governed by eligible funeral arrangements.

The exceptions to the new trust reporting rules are quite narrow and trustees should not assume that their trusts meet the exclusion criteria. The fact that the trust earns no income and has no activity does not exempt the trust from having to file a return.

Practical considerations

The legislation creates many practical issues for trustees who have never had a filing obligation in the past. Some of the trusts who may now have a filing requirement include:

- Family trusts, commonly used in estate planning, whose sole purpose is to hold growth shares in a family business, which have never before recognized any income or capital gains;
- Trusts holding personal-use property, such as vacation homes;
- "In-trust for" accounts for minors with balances exceeding $50,000 throughout the year;
- Lawyers' client-specific trust accounts that are in existence longer than three months;
- Internal trusts held by registered charities in their capacity as trustee (e.g., certain endowment funds, donor-advised funds, etc.); and
- Bare trust arrangements, where beneficial ownership and legal ownership of property have been segregated.

Many of these trusts will not have prepared the annual financial information necessary to comply with the reporting.

Additionally, identifying all reportable parties and gathering the necessary information to comply with the enhanced reporting requirements may require substantial time, financial resources, and legal analysis. Disclosures must be completed for all beneficiaries (including residual or contingent beneficiaries), trustees, settlors, and protectors. Given the broad definition of "settlor" in these new disclosure rules, trustees will need to review historical trust transactions to determine whether a non-arm's length person has lent or otherwise transferred property to the trust, such as for the payment of professional fees in relation to the trust property. A review of the organizational structure may be necessary to identify all beneficiaries. In some cases, beneficiaries may need to be advised of their interest in the trust to ensure a reasonable effort in gathering the reportable information is made by the trustees.

Lastly, trustees should ensure a trust number is obtained so the tax return can be filed in time for the March 2024 deadline.

Summary

The enhanced trust reporting and disclosure legislation is complex. Speak to your Deloitte advisor sooner rather than later to prepare your trust(s) for compliance. We will assist you in navigating the rules and planning for an efficient information-gathering process.

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