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TAXSTRATEGY

Trusts

New Requirements

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Back in March of this year, I wrote about the new proposed changes as contained in the 2018 Federal Budget. One issue that I mentioned was the new reporting requirements for trusts. Now most of my readers will say, "Trusts, again?"

You love to talk about trusts. And well, yes, that's true. Trusts are a great family estate-planning vehicle, but the reason I love to talk about trusts, is that there is so much to talk about. Whether it's how they are formed (it's all about intent folks!), how they are taxed (the Tax Act is full of rules to navigate) or how they are administered (yes, the CRA is interested in this too!), the topics are endless.

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One thing that I wanted to focus on is the tax reporting requirements for trusts. It's an interesting conundrum: Trusts are not technically legal entities. Rather, it's the trustees, acting on behalf of the trust, that have legal capacity. In fact, when I draft documents to which a trust is a party, the contracting person is actually the trustee of the trust, and not the trust itself. Yet, under the Tax Act in Canada, a trust is a separate taxable entity, which means that it is a taxpayer in its own right and has to report any income and pay taxes on that income (to the extent it has not allocated any income out in the same taxation year to a beneficiary). This means a trust has to also file a tax return.

Just what are trusts?

Trusts are like individuals in that they must have a calendar year end. In order to ensure that a tax is able to allocate its income to its beneficiaries so that income is taxed in the beneficiaries' hands and not in the trust, allocations and trustee resolutions evidencing the allocations must be done by the end of the day on December 31 in each. The problem is that if a trust happens to hold an investment account, the trustees won't actually know what the income for the full year will be until after December 31. So we normally advise trustees to document the allocation as a percentage of the total net income for the year, even though they don't have the actual numbers.

Another anomaly with trusts is that unlike individuals, a trust has a much shorter period in which it has to file a return (known as a T3). You and I have until April 30 of the following year to file our tax returns. However, a trust must file its tax return within 90 days of its year-end, meaning March 30. Why is that? Your guess is as good as mine.

Currently, filing a T3 has not been too taxing (pun intended). For those that value privacy, the information to be disclosed as it relates to the trust (other than its income) was relatively simple. The trustee, name of the trust and address had to be disclosed. If the trust distributed any assets, the beneficiary that received the asset had to be listed. If there was a change to the beneficiaries, that had to be dis-

closed and the name of the new beneficiary had to be listed. But otherwise, the information disclosed was not too onerous.

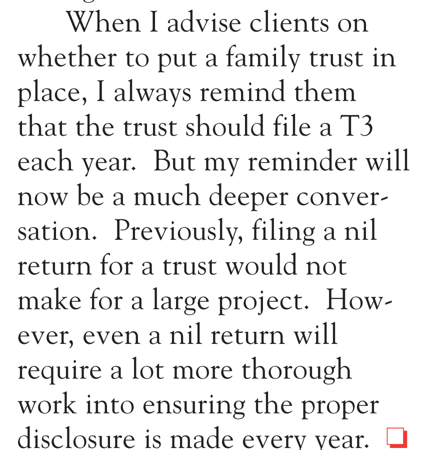
New Rules

However, earlier this year, the Federal Government announced new measures as it relates to the T3 and transparency. For 2021 and subsequent tax years, additional information will be required on trust T3 (for both domestic and non-resident trusts that are deemed resident). Specifically, disclosure is to be made for all trustees, beneficiaries and settlors (including anyone who is able to exert control over trustee decisions in relation to allocations of trust income or capital, such as a Protector). Certain trusts are excluded, including graduated rate estates, qualified disability trusts, non-profit trusts and registered charities or trusts that are less than three months old or that generally holds less than $50,000 worth in assets throughout the year (provided that the assets do not include shares of a private company or real estate).

However, if you have a typical discretionary family trust that holds value more than $50,000, then you no longer have the privilege of complete privacy. So, if you formed a discretionary trust where you included everyone but the family dog as a discretionary beneficiary, the disclosure requirements may well cause a large headache for you. What if your class of beneficiaries includes contingent beneficiaries? How do you determine who needs to be part of the disclosure? The new proposed rules provides that the requirement to disclose will be met if the required information is provided in respect of each beneficiary whose identity is known or ascertained with reasonable effort by the person who is filing the return for the trust.

Another change to be aware of is that under the existing rules, a trust may not be required to file an income tax return in certain circumstances, including if there is no trust income payable for the year. However under the new rules, a trust will be required to file a T3 each year; this requirement is in respect of "express trusts".

So what is an express trust? Although the Tax Act does not actually provide a definition for an express trust, it would appear that, based on common law and legal textbooks, an express trust would be one that is deliberately created. So this would appear to capture all discretionary family trusts. So the short of it is that every discretionary family trust will be required to file a T3 every year, even if there is no income for the year.



And to reinforce these new rules, new penalties will be introduced for failure to file a T3 with the proper disclosure information ($25 a day with a minimum of $100 and a maximum of $2500). If the failure to file was made knowingly or due to gross negligence, there is an additional penalty of 5% of the maximum fair market value of the property held (with a minimum penalty of $2500). This latter penalty can end up being quite punitive if a family trust is sitting on shares of a company that has significant value.

When I advise clients on whether to put a family trust in place, I always remind them that the trust should file a T3 each year. But my reminder will now be a much deeper conversation. Previously, filing a nil return for a trust would not make for a large project. However, even a nil return will require a lot more thorough work into ensuring the proper disclosure is made every year. ❑

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