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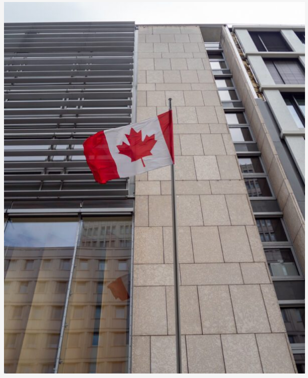
Guide to new Canadian trust reporting rules

MARCH 7, 2024 9 MIN READ



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Update:

On March 28, 2024, the Canada Revenue Agency announced that "[i]n recognition that the new reporting requirements for bare trusts have had an unintended impact on Canadians, the Canada Revenue Agency (CRA) will not require bare trusts to file a T3 Income Tax and Information Return (T3 return), including Schedule 15 (Beneficial Ownership Information of a Trust), for the 2023 tax year, unless the CRA makes a direct request for these filings." The announcement noted that "[o]ver the coming months, the CRA will work with the Department of Finance to further clarify its guidance on this filing requirement. The CRA will communicate with Canadians as further information becomes available."

The Canadian federal government introduced new rules for trust reporting that apply to taxation years ending after December 30, 2023, with significant potential penalties for failure to comply. The first filing deadline under the new rules for trusts with a December 31, 2023, year end is April 2, 2024 (the first business day after the 90-day deadline).

The new rules require a broader range of trusts to file T3 trust income tax and information returns than under the prior rules, including certain bare trusts, and expand the information that most trusts are required to provide. Two recent technical interpretations of the Canada Revenue Agency (CRA) confirmed that the new rules apply only to entities that are trusts under the applicable private law (or deemed trusts for purposes of the *Income Tax Act* (Canada) (ITA)), but uncertainties remain regarding the scope of the application of the new rules.

More trusts have to report

Under the old rules, a wide range of trusts benefitted from two exemptions from Canadian tax reporting:

1. Non-corporate taxpayers, including trusts, did not have to file an income tax return for a taxation year where they did not owe any tax under the ITA, did not dispose of capital property or realize a taxable capital gain (or, for non-residents, dispose of taxable Canadian property or realize a non-excluded taxable capital gain) and did not have a positive balance in their Home Buyers' or Lifelong Learning Plans (the general exemption).
2. A reference to "trust" in the ITA is deemed to exclude an arrangement under which a trust

can reasonably be considered to act as an agent for all the beneficiaries under the trust with respect to all dealings with all of the trust's property (the bare trust exclusion). The old rules provided that no reporting was required by trusts benefiting from the bare trust exclusion.

The new rules, which were enacted in 2022 for taxation years ending after December 30, 2023, reverse both of these exemptions for certain trusts:

1. All trusts that are (i) resident in Canada (including certain foreign trusts that are deemed to be resident in Canada) and (ii) are express trusts (or, in Québec, were not established by law or judgment) can no longer benefit from the general exemption *unless* the trust qualifies for one of 15 listed types of trusts — referred to by the CRA as listed trusts — including where
   1. the trust existed for less than three months by the end of the year
   2. the trust held no more than $50,000 in assets throughout the year, all of which are specified types (including money and shares traded on a designated stock exchange)
   3. the trust is a registered charity
   4. the trust is a mutual fund trust
   5. all units of the trust are listed on a designated stock exchange
   6. the trust is a graduated rate estate
   7. the trust is governed by or exists under specified plans, accounts or funds, including RRSPs, RDSPs, RESPs, RPPs and TSFAs

The general exemption continues to apply without any changes to non-corporate taxpayers other than trusts.

1. For purposes of the trust reporting rules, a trust now specifically includes a trust that otherwise qualifies for the bare trust exclusion. As a result, trust reporting is now required for a trust that qualifies under the bare trust exclusion notwithstanding that such a trust continues to be deemed not to be a trust for most other provisions of the ITA.

In two recent technical interpretations, the CRA clarified that the new reporting rules apply only where a trust exists under the applicable underlying private law (namely civil law in Québec and common law elsewhere). This clarification is welcome as some commentators had been concerned that the reference to "an arrangement" in the new rules (which mirrors the language of the bare trust exclusion) could potentially have been intended to expand the scope of the new rules to entities that are not otherwise trusts under private law (or entities that are not otherwise deemed to be trusts for purposes of the ITA).

As a result, taxpayers should be aware of the new filing obligations and additional disclosure requirements set out below in the following circumstances:

1. Ordinary trusts, entities deemed to be trusts for purposes of the ITA and trusts falling within the bare trust exclusion are subject to the trust reporting rules unless they qualify for an exemption.
2. Nominee or agency arrangements that may have some trust-like features, or that use some trust-like language in the relevant documentation, but that are not trusts under the applicable private law are not subject to the trust reporting rules. However, the existence of trust-like features or trust-like language in the relevant documentation could create

uncertainty as to whether there is a trust under the applicable private law, and could therefore increase the risk of the CRA on audit taking the position that a trust exists under the applicable private law. As a result, in these circumstances it may be prudent to report under the trust reporting rules to mitigate the risk of the CRA assessing penalties on audit.
3. Nominee or agency arrangements that are not trusts under private law are not subject to the trust reporting rules. Accordingly, the new rules do not create any reporting obligations for such arrangements.

We note that some commentators have suggested that trust reporting may be required in both scenarios 2 and 3 above. However, the recent CRA technical interpretations (which are consistent with the text of the relevant provisions) confirm that reporting should not be required where a trust does not exist under private law and no provision of the ITA deems a trust to exist.

Expanded reporting requirements

All trusts required to file a T3 return (other than listed trusts) must now complete new Schedule 15. The key information required by Schedule 15 is

- the name, address, date of birth (if applicable), country of residence and taxpayer identification number (e.g., social insurance or business number) of
  - any person who was a trustee, beneficiary or settlor of the trust at any point during the year
  - any person who, at any point during the year, had the ability to “exert influence over trustee decisions regarding the appointment of income or capital of the trust” pursuant to the terms of the trust or a related agreement
- information regarding beneficiaries whose identities are unknown at the time of filing (e.g., unborn children and future spouses)

Only beneficiaries that are either known or whose identity can be determined with “reasonable effort” when filing the return must be listed. Special rules also apply to certain Indigenous trusts and to trusts where some but not all of their units are listed on a designated stock exchange (in which case the information only needs to be provided in respect of beneficiaries of classes of units that are not so listed).

The 2023 T3 Trust Guide confirms that the beneficiaries to be listed for reporting purposes are to be determined under general trust law principles, rather than under an expanded meaning of “beneficially interested” under the ITA.

The term “settlor” has a broader meaning for purposes of the trust reporting rules than under private law. As defined for such purposes, “settlor” refers to any individual or partnership that has provided a loan or transferred property, directly or indirectly, to the trust. However, this definition excludes loans bearing a reasonable rate of interest and transfers for fair market value consideration to the trust, in each case by a person or partnership that deals at arm’s length with the trust.

Trusts filing a return for the first time must provide a copy of the trust document (if any) if they have not previously submitted it to the CRA (e.g., when applying for a trust account number). The CRA has acknowledged that a written trust document may not always exist, in which case a description of the trust arrangement should be provided that includes its date of creation and the names of all trustees, beneficiaries and settlors.

Where a trust that qualifies under the bare trust exclusion is subject to the new reporting requirements, regard should be had to the 2023 T3 Trust Guide published by the CRA, which has instructions for how the T3 return should be completed (including what name to use if the trust is currently unnamed and which sections can be left blank).

Penalties and grace period

A new penalty provides that where a trust was grossly negligent in failing to file as required, or makes a false statement or omission in the required return, it will be subject to a penalty equal to 5% of the value of the trust's property (based on its highest value during the year) or $2,500, whichever amount is higher. Listed trusts are not subject to the penalty.

Exceptionally, the CRA has announced that it will waive the normal failure-to-file penalty for trusts that qualify under the bare trust exclusion in respect of the 2023 taxation year. The CRA explained that it is "adopting an education-first approach to compliance and providing proactive relief" through the waiver. However, the waiver only applies to the normal failure-to-file penalty; it does not apply to the new gross negligence penalty set out in the previous paragraph.

Analysis and takeaways

The new reporting rules create a significant administrative burden, and in many cases will have limited utility for the CRA. Nevertheless, the substantial new penalties demand that taxpayers take care to comply with the new reporting, including in respect of certain trusts that were previously exempt from reporting.

Unfortunately, uncertainties remain regarding whether particular arrangements that have some trust-like features or that use certain trust language may be considered trusts under the applicable private law, and therefore whether reporting may be required. In particular, the requirement for reporting in respect of trusts that qualify for the bare trust exclusion has led some commentators to raise concerns that reporting may also be required for other arrangements in which there is no trust established under private law. Although the CRA's recent technical interpretations interpret the rules reasonably and in a manner consistent with their text, further administrative guidance would be helpful to provide certainty to taxpayers. This certainty is particularly important given the significant penalties that can be imposed for noncompliance.

Where the presence of a trust relationship is uncertain and a T3 return is being filed on a conservative basis, consideration should be given to noting to the CRA that the T3 return is being filed out of an abundance of caution on a protective basis, and is not an admission that the arrangement constitutes a trust. This note would help mitigate against any inference that the filing of the T3 return is somehow evidence of the existence of a trust and that the reporting party is acting as a trustee with the attendant fiduciary duty of trustees (which are generally more onerous than those of non-fiduciary custodians).

For further information on the new trust reporting rules, please contact any member of our National Tax Group.