New Tax Reporting Requirements for Trusts

Trusts are powerful instruments in tax and estate planning. Broadly speaking, a trust is a relationship between a settlor and a trustee[1] in which the trustee holds property transferred by the settlor for the benefit of beneficiaries, specified by the settlor. Using this basic framework, a variety of arrangements are possible and significant planning objectives can be met. This article focuses on the tax reporting requirements for trusts, particularly, recent changes to these requirements for trust taxation years ending on, or after December 31, 2023.

For tax purposes, a trust is considered an (individual) taxpayer which entails a number of tax filing requirements with which the trustee(s) must comply. In the 2018 Federal Budget,[2] the government proposed to expand these tax reporting requirements. After several iterations delayed the date of implementation, these new reporting requirements are now effective for trust taxation years ending on, or after December 31, 2023. As most trusts have a calendar year-end for tax purposes, the new requirements are relevant for most trustees in preparing 2023 trust income tax returns.

What are the previous rules?

For taxation years ending on, or before December 30, 2023, an (inactive) trust that does not earn income or make distributions within the year is generally not required to file an annual ("T3") return of income. Conversely, if the trust has tax payable or if it distributes all or part of its income or capital to its beneficiaries, a T3 return must be filed. Previously, trustees were not required to disclose the identities of settlors, trustees or beneficiaries on an annual basis. In cases where the trust merely held property and did not receive and/or distribute any income during the year, the trustee would not usually prepare and file a trust tax return for that particular year.

What are the new rules?

To improve the collection of beneficial ownership information, the recently-enacted legislation introduced a series of new trust reporting requirements, including the following:

- "Express trusts" must file a tax return for each taxation year, regardless of income or distributions to beneficiaries, subject to certain exceptions; and
- These trusts must disclose detailed information about the settlors, trustees, beneficiaries and individuals who could exert control over trustee decisions regarding the appointment of income or capital of the trust (e.g., protectors), including:
  - Name;
  - Address;
  - Date of birth;
  - Jurisdiction of residence; and
  - Taxpayer identification number (such as SIN, trust account number, business number or taxpayer identification number used in a foreign jurisdiction, as applicable).

However, information that is subject to solicitor-client privilege is excluded from these new reporting requirements.

Who is impacted by the new rules?

The new rules apply to express trusts (or for civil law purposes, any trust other than a trust that is established by law or by judgement), subject to some exceptions.[3] The Canada Revenue Agency ("CRA") considers an express trust to be "a trust created with the settlor's express intent, usually made in writing (as opposed to a resulting or constructive trust, or certain trusts deemed to arise under the provision of a statute)." In addition, it is important to note that these reporting requirements will now apply to an arrangement where a trust can reasonably be considered to act as an agent for its beneficiaries with respect to all dealings in all of the trust's property (i.e., a "bare trust"), even where no income has been earned or no taxes are payable by the trust.

While trusts have always been subject to T3 Trust reporting obligations, several trust arrangements that have been exempted from the trust reporting rules (such as "bare trusts" or formal trusts that do not have income to report in the year) will now require annual filings. You may be wondering if the new T3 Trust reporting rules apply to you. Let's start with a few questions that you can ask yourself to see if you have an arrangement or formal trust in place that may be subject to this new trust reporting obligation:

- Have you set up an in-trust bank account for a child or grandchild?
- Did you set up a corporation to hold bare title to real estate so that it could be held separately from other real estate that you own?
- Have you set up a trust arrangement to hold your family cottage?
- Did you or your spouse (or common-law partner) transfer your investment portfolio or other assets to a trust?
- Did you add another person, such as your child, as a joint owner to a bank account or investment account for the purpose of avoiding probate fees on your death?
- Did you add another person as a joint owner on title to real estate for the purpose of avoiding probate fees on your death? (This scenario is commonly seen when a parent has added a child on joint title to land or other real estate property to avoid the requirement for probate on the passing of the parent.)
- Are you a co-signor on financing and are registered on title to the property as a joint owner for the purpose of securing mortgage financing? (This scenario is commonly seen where a child purchases a home and parent is registered on title for the property to assist the child in securing financing.)

If you answered yes to any of the above questions, then you may have to file a T3 tax return annually, in respect of that trust arrangement, even if no income was earned in the trust, or if the income earned will be reported by a financial institution to the account holder. The above scenarios are examples of circumstances where an express trust may have been created and thus might be subject to the new reporting rules.

Note that it is a question of fact whether an express trust has been created in an ownership arrangement that lacks written evidence of its creation, such as when there is no formal trust deed. Further, not all express trusts described above will be subject to the filing requirements if they meet any of the new exceptions outlined in the tax legislation. For example, where a bank account is established in trust for a minor, this could be an express trust that may require a T3 Trust return filing. However, as noted subsequently[3], if the account only holds cash and has less than $50,000 held in the account throughout the year, it will be exempt from the new trust reporting requirement for the year. The rules are complex and require specialized advice to navigate. Please consult with your own tax or legal professional to obtain independent legal advice about your situation as the penalties for non-compliance if a trust is created and is required to file can be substantial.

What are the penalties for failure to comply?

Failure to file the return or file the required disclosures on a timely basis could result in a penalty of $25 per day (minimum $100), up to a maximum of $2,500 per year. However, more punitive penalties may apply in some circumstances, equal to the greater of:

- $2,500; and
- Five per cent of the highest value at any time in the year of all property held by the trust at that time.

These more serious penalties apply to situations in which any person or partnership:

- Fails to comply with a demand to file a trust tax return; or
- Knowingly or under circumstances amounting to gross negligence:
  - Makes or acquiesces in the making of a false statement or omission in the trust tax return; or
  - Fails to file a trust tax return.

Seek advice

The new trust reporting requirements greatly expand the number of trusts subject to annual tax filing requirements as well as the amount of information trustees are required to collect and disclose each year. Furthermore, trustees are exposed to potentially severe penalties if they fail to comply with the new reporting requirements. As such, it is recommended that the trustees of any trust work with their tax and/or legal advisors to confirm if the new rules will apply to them and, if so, collect the necessary information immediately to ensure compliance for 2023 and subsequent taxation years before the deadline (April 2, 2024 for trusts with a December 31, 2023 year-end)[4]. Trustees may also wish to consider a wind-up of any inactive trusts (including bare trust arrangements) to avoid future reporting obligations (after 2023).

It is further recommended that persons considering the establishment of a trust give careful thought to the person(s) being appointed as trustee(s). Appointing a corporate trustee, such as BMO Trust Company, can provide considerable peace of mind given the ever-evolving responsibilities that apply to trustees.

For more information, please speak with one of our team members.

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The trust reporting and disclosure obligations contained in this publication may or may not apply to your situation. As such, we recommend that you consult with your independent tax and legal professionals to determine the annual reporting obligations applicable to your situation and to ensure proper documentation.

[1] Or a patrimony by appropriation, autonomous and distinct under the Civil Code of Quebec.

[2] The Quebec government has amended its tax legislation and regulations to incorporate the changes made to the Federal legislation and regulations relating to trusts, in accordance with their general principles, subject to certain exceptions (such as the applicable penalties).

[3] Exceptions to the new reporting requirements include the following types of trusts:

- Mutual fund trusts, segregated funds and master trusts;
- Trusts governed by registered plans (i.e., deferred profit-sharing plans, pooled registered pension plans, Registered Disability Savings Plans, Registered Education Savings Plans, registered pension plans, Registered Retirement Income Funds, Registered Retirement Savings Plans, First Time Home Savings Accounts, and Tax-Free Savings Accounts);
- Lawyers' general trust accounts;
- Publicly-traded trusts, all of the units of which are listed on a designated stock exchange;
- Graduated rate estates and qualified disability trusts;
- Trusts that qualify as non-profit organizations or registered charities;
- Trusts that have been in existence for less than three months (at the end of the year);
- Trusts that hold less than $50,000 in assets throughout the taxation year (provided that their holdings are confined to money, debt obligations and listed securities); and
- Certain other specified trusts.

[4] Extended to April 2, 2024 as the March 30, 2024 deadline falls on a weekend.

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