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Tax Alert – Canada

Proposed trust additional reporting requirements

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 4 February 2022, the Department of Finance released for public comment draft legislative proposals (and accompanying explanatory notes) to implement most of the remaining measures from the 2021 federal budget. For further details, see EY Tax Alert 2022 Issue No. 3, *Finance releases draft legislation for 2021 budget measures*.

The 4 February 2022 proposals also include measures subjecting express trusts to additional reporting requirements, with some significant amendments from the original legislative proposals that were introduced in July 2018.

Background

Changes to trust reporting requirements were first proposed in the 2018 federal budget and subsequently released as draft legislation on 27 July 2018.

Under the current rules, the *Income Tax Act* (Canada) (the Act) requires a trust to file an annual income tax return, the T3 Trust Income Tax and Information Return (T3 return), within 90 days of the end of its taxation year. However, there are a number of statutory and administrative exceptions to this filing requirement. As a result, a trust generally has a filing obligation in a taxation year only if any one of a number of criteria is met, including (but not limited to):

- The trust has tax payable;

- The trust is resident in Canada and has disposed of (or is deemed to have disposed of) a capital property, or has realized a taxable capital gain;
- The trust is a deemed resident trust; or
- The trust receives from the trust property any income, gain or profit that is allocated to one or more beneficiaries (if the trust has total income from all sources of more than $500, or income of more than $100 allocated to any single beneficiary, has made a distribution of capital to one or more beneficiaries, or allocated any portion of the income to a nonresident beneficiary).

Also, a trust that is nonresident throughout the year has to file a T3 return if it has realized a taxable capital gain or has disposed of taxable Canadian property (as defined under subsection 248(1) of the Act), subject to certain exceptions.

27 July 2018 draft proposals

Additional information reporting requirements were first proposed in draft legislation that was released on 27 July 2018. The proposals were applicable on an annual basis to a trust that is resident in Canada (including a trust that is deemed resident in Canada under section 94 of the Act) and that is also an express trust (a trust that is created with the settlor's express written intent, as opposed to a trust arising by operation of law), subject to certain exceptions (see below) or a nonresident trust if it is currently required to file a T3 return, effective for taxation years ending after 30 December 2021. The proposed rules would increase the compliance burden for existing trusts and create an annual T3 return filing requirement for certain trusts that are currently not required to file a T3 return due to statutory or administrative exceptions.

Under proposed section 204.2 of the Income Tax Regulations, trusts subject to the proposed additional reporting requirements would have to report the identity of, and include certain prescribed information for, any person who is a trustee, beneficiary or settlor of the trust, or any person who has the ability, as a result of the trust terms or a related agreement, to exert influence over trustee decisions regarding the allocation of trust income or capital of the trust in a year (e.g., a protector of the trust). The required information includes the name, address, date of birth (in the case of an individual other than a trust), jurisdiction of residence and taxpayer identification number in respect of these persons. A new beneficial ownership schedule (proposed T3 Schedule 15) would be added to the T3 return to report this information. Quebec announced in its 2021 budget its intention to harmonize with the federal proposals. See EY Tax Alert 2021 Issue No. 11, *Quebec budget 2021-22*.

Since trusts, other than Graduated Rate Estates (as defined under subsection 248(1) of the Act), are required to have a calendar year-end, the proposed rules would have applied as of the 2021 taxation year, based on the effective date noted in the July 2018 proposals.

On 14 January 2022, the Canada Revenue Agency (CRA) announced that it would not begin administering the proposals before the related draft legislation was enacted. In the meantime, the CRA would continue to administer the existing rules for trusts. It also confirmed that Schedule 15 would not be part of the published 2021 T3 return. Revenu Québec announced recently that completion of Part 6 and Schedule G of the TP-646-V Quebec income tax return (the Quebec version of proposed T3 Schedule 15) would be optional for the 2021 taxation year.

4 February 2022 draft amendments

The 4 February 2022 draft legislation includes the additional reporting requirements proposals for trusts that were originally released in July 2018, with a number of significant amendments, as follows:

- The implementation of the proposals is deferred by one year, applicable to taxation years ending after 30 December 2022. As a result, for trusts with a calendar year-end (generally the case, as noted above), these rules will apply beginning with their 2022 taxation year instead of with the 2021 taxation year as previously proposed.
- The proposals will not require the disclosure of information that is subject to solicitor-client privilege, under proposed subsection 150(1.4) of the Act.
- The list of exceptions to the application of the proposals included in proposed subsection 150(1.2) of the Act is being expanded to except a trust for which all units are listed on a designated stock exchange.
- The proposals will apply to a trust that includes an arrangement where it can reasonably be considered to act as agent for its beneficiary(s) with respect to all dealings in all of the trust's property (bare trusts) under proposed subsection 150(1.3) of the Act.

Exceptions from the additional reporting requirements

As noted above, proposed subsection 150(1.2) lists certain types of trusts that will be excepted from these additional reporting requirements, including a trust that:

- Has been in existence for less than three months at the end of the year;
- Holds only certain assets and those assets have a total fair market value that does not exceed $50,000 throughout the year;
- Qualifies as a non-profit organization that is a club, society or association described in paragraph 149(1)(l) or a registered charity;
- Is a mutual fund trust or master trust or is a segregated fund;
- Has all of its units listed on a designated stock exchange (as noted above);
- Is a graduated rate estate;

- Is a qualified disability trust;
- Is an employee life and health trust; or
- Is 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, or registered retirement savings plan.

Certain other exceptions are also included in proposed subsection 150(1.2).

New penalties will apply, under proposed subsections 163(5) and (6), to any person or partnership that is subject to the additional reporting requirements in proposed section 204.2 of the Income Tax Regulations and who fails to file a T3 return (including the proposed Schedule 15 beneficial ownership schedule) for the taxation year. These proposed penalties will be equal to the greater of $2,500 or 5% of the highest total fair market value of all property held by the trust in the year. This penalty will also apply if a false statement or omission is knowingly made in the return or made under circumstances amounting to gross negligence. For Quebec tax purposes, the 2021 Quebec budget proposed that the amount of the penalty would be $1,000 plus $100 for each day the failure to file continues, up to $5,000.

Next steps

Comments may be submitted by the public to the Department of Finance on the trust reporting requirement proposals no later than 5 April 2022.

The one-year deferral of the implementation of these proposals is welcome news and will provide trustees and other stakeholders with additional time to prepare. Since 2022 will be the first taxation year that affected trusts will need to comply with the proposed additional reporting requirements, steps may be taken in the months ahead to begin gathering the new required information with respect to settlors, trustees, beneficiaries and persons able to exert influence over trustee decisions over the allocation of trust income or capital.

Learn more

For more information on the proposed trust additional reporting requirements, please contact your EY or EY Law tax advisor or one of the following professionals:

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