TAX NOTES

October 28, 2020

New Trust Reporting Rules

Many trusts will be subject to proposed new reporting rules ("**Reporting Rules**") for their taxation years ending on or after December 31, 2021. These trusts will now be required to disclose personal information to the Canada Revenue Agency ("**CRA**") concerning their settlors, trustees, beneficiaries, and other persons that can exert control over the trust (such as protectors).

It is important that the trustees, accountants, and other advisors involved in preparing a trust's T3 tax returns understand the Reporting Rules. It should be noted that:

- the current draft of the Reporting Rules is broad, includes significant ambiguities, and may impose burdensome information gathering obligations on trustees;
- there is an increased risk of personal liability for trustees, as gross negligence penalties for non-compliance is the greater of $2,500 and 5% of the fair market value of a trust's assets; and
- it may be prudent to take action before the end of 2020 to proactively address the Reporting Rules.

New Filing Requirement

Currently, trusts are not required to file a tax return in all cases. For example, a trust need not file a tax return where there is no tax payable in a taxation year. However, the Reporting Rules create a new filing requirement for many trusts regardless of whether the trust has tax payable. All "express trusts" which are resident in Canada, or deemed to be resident in Canada, will be required to file a tax return, subject to certain exceptions. The types of trusts which will be exempt include:

- mutual fund trusts;
- trusts governed by certain registered plans;
- lawyers' general trust accounts;
- 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; and
- trusts that hold less than $50,000 in assets throughout the taxation year (provided, that their holdings are confined to certain assets such as cash, government debt obligations, and listed securities).

Additional Disclosure Required

Where the Reporting Rules apply, the trust will be required to report the identity of all trustees, beneficiaries and settlors of the trust, as well as the identity of each person who has the ability (through the trust terms or a related agreement) to exert control over trustee decisions regarding the appointment of income or capital of the trust (e.g., a protector). For each such person, the following information must also be disclosed:

- address;
- date of birth;
- jurisdiction of residence; and
- taxpayer number (e.g., SIN or business number).

Penalties

There are new penalties to address non-compliance with the Reporting Rules.

A penalty will be imposed equal to $25 for each day of delinquency in making the required filings, with a minimum penalty of $100 and a maximum penalty of $2,500.

More significantly, if a failure to file the required information was made knowingly, or in circumstances amounting to gross negligence, an additional penalty will apply. The additional penalty, which may be imposed on individual trustees, will be equal to 5% of the fair market value of the trust's property held during the relevant year. The penalty is computed based on the highest fair market value at any particular time during the year.

Selected Issues

The Reporting Rules are apparently intended to improve the federal government's collection of beneficial ownership information. The federal government appears concerned that the current lack of beneficial ownership information is an obstacle to determining a taxpayer's tax liabilities, and is facilitating aggressive tax avoidance, tax evasion, and money laundering.

These are a number of interpretive issues with the draft legislation for the Reporting Rules. These interpretive issues create uncertainty and compliance concerns for trustees and their advisors. The potential scope of the Reporting Rules may extend beyond the federal government's intended purposes. Given the significant potential for liability exposure for trustees, in particular, it is important to be aware of these interpretive issues. Questions trustees should consider include the following.

- In addition to disclosing information for named beneficiaries, is disclosure required for everyone who is "beneficially interested" in the trust, as defined in subsection 248(25)?

- Is disclosure required in respect of anyone who contributed or loaned funds to the trust in the past, pursuant to the definition of "settlor" in subsection 17(15)?

- Do the Reporting Rules also apply to, in addition to protectors, parties with the ability to control trustee decisions more broadly (e.g., through instruments such as a shareholders' agreement)?

- How much effort will be required for a trustee to track down the required personal information of a beneficiary to ensure that the significant penalties will not apply?

- What actions will a trustee take if a beneficiary refuses to cooperate or provide the required personal information to a trustee, such that they "knowingly" did not provide it?

- Is the lack of an exemption for a lawyer's client-specific trust account unconstitutional for breach of solicitor-client privilege?

Conclusion

Given the breadth of the information required to be collected and disclosed to the federal government going forward, certain trusts may want to take action to avoid or mitigate the effects of the Reporting Rules.

Certain actions should be taken before the end of 2020, while others may potentially be taken in 2021 or later. In particular, where a trust amendment or dissolution is desired, these transactions should be completed before the end of 2020.[1] Trustees should consult with their professional advisors.

[1] For example, in the case of a trust dissolution, if this is not implemented until sometime in 2021, the final taxation year of that trust should end on December 31, 2021. Consequently, the Reporting Rules should still apply to that trust. See paragraph 249(1)(c) and CRA Document 2018-0744081C6, "STEP 2018 - Q3 - Trust return due date on wind-up", May 29, 2018.