

NEW AND EXPANDED TRUST REPORTING: It's Here!

New rules aimed at providing more transparency on beneficial ownership of assets now require that **more trusts** (and estates) **file tax returns**. These changes will **catch many individuals and businesses** that **may not be aware** of their trust-like relationships, exposing them to potential **penalties** and other consequences for non-compliance. The rules become effective in 2023, with a filing deadline of **April 2, 2024**.

Unexpected exposure – bare trust arrangements

The rules have been **expanded** to **include** cases where a **trust acts as an agent** for its beneficiaries, commonly known as a **bare trust**. In such instances, the **person/entity listed as the owner** of an asset is **not the true beneficial owner**; instead, they hold the asset on behalf of another party.

STEP 1: Does a bare trust arrangement exist?

To determine if a bare trust arrangement exists, the following question should be asked:

- **Is the person on title or holding the asset the true beneficial owner?** For example, do they get the benefits of the asset (such as sale proceeds) and bear the costs or risks of the asset (such as property taxes)?

There is likely a bare trust arrangement if there is a mismatch between legal and beneficial ownership, often requiring a trust return.

There are **several reasons** why an **individual, business or organization** may use a **bare trust arrangement**. Many parties involved in a bare trust arrangement may **not realize** that they are, much less that there may be a filing requirement with CRA. **No lawyer** may have ever been involved, and **no written agreement** may have ever been drafted.

While there are **countless possibilities of bare trust arrangements**, the following lists **some** common potential **examples**.

Individual Reasons

- a parent is on **title of a child's home** (without the parent having beneficial ownership) to **assist** the child in **obtaining a mortgage**;
- a parent or grandparent holds an **investment or bank account in trust** for a child or grandchild;
- **one spouse** is on **title of a house** or asset although the other spouse is at least a partial beneficial owner;

Estate Planning Reasons

- a child is on **title of a parent's home** (without the child having beneficial ownership) for probate or estate planning purposes only;
- a child is on **parent's financial accounts** (or other assets) to assist with administration after the parent's passing;

Business Administration Reasons

- a **corporate bank account** is **opened by the shareholders** with the corporation being the beneficial owner of the funds;
- a **corporation** is on **title of an individual's real estate, vehicle or other asset**, and vice-versa;
- assets **registered to one corporation** but beneficially **owned by a related corporation**;
- use of a **nominee corporation** for real estate development purposes;
- a **partner of a partnership** holding a **bank account or asset** for the benefit of all the other partners of a partnership;

- a **joint venture** arrangement where the operator holds legal title to development property as an agent for the benefit of other participants;
- a **cost-sharing arrangement** where a person holds a business bank account, or other assets, to facilitate the arrangement while having no, or only partial, beneficial interest in these shared assets;

Industry-specific Issues

- a **property management company** holding operational bank accounts in trust for their clients, or individuals managing properties for other corporations holding bank accounts for those other corporations; and
- a **lawyer's specific trust account** (while a lawyer's general trust account is largely carved out of the filing requirements, a specific trust account is not).

CRA has not commented on several of the examples; it is uncertain how they will interpret and enforce the law.

STEP 2: Does a trust return need to be filed?

After determining that a bare trust arrangement exists, it is important to determine **whether an exception from filing a trust return is available**.

Some of the more **common exceptions** include the following:

- trusts in existence for **less than three months** at the end of the year;
- trusts holding **only assets within a prescribed listing** that is very restrictive (such items in the listing include **cash and publicly listed shares**) with a total fair market value that does **not exceed \$50,000 at any time in the year**;
- **trusts required by law** or under rules of professional conduct to **hold funds** related to the activity **regulated** thereunder, **excluding** any trust that is maintained as a separate **trust for a particular client** (this applies to a lawyer's general trust account, but not specific client accounts); and
- registered **charities** and **non-profit clubs**, societies or associations.

A trust return must be filed if one of the exceptions are not met. Even where one of the new exceptions is met, a trust would still have to file a return if they had to file under the prior rules, such as the trust having taxes payable or having disposed of capital property.

STEP 3: What information must be disclosed?

Where a trust is required to file a tax return, the **identity** of all the **trustees** (who is on title or holds the asset), **beneficiaries** (who really owns the asset), **settlers** (who owned the asset originally) and anyone with the **ability** to exert **influence** over **trustee decisions** regarding the income or capital of the trust must be disclosed.

Such required information includes:

- **name**;
- **address**;
- **date of birth** (if applicable);
- **country of residence**; and
- **tax identification number** (e.g. **social insurance number**, business number, trust number).

Obtaining this information proactively is especially helpful, particularly if those involved are no longer in close contact.

Traditional trusts

Under the **previous rules**, a trust was required to file a **trust return** if one of several conditions were met, such as the **trust having taxes payable** or **disposing of capital property**. Many trusts did not meet a condition and, therefore, were not required to file a trust return previously. For example, many trusts owning shares of a private corporation were historically not required to file in years when there were no share sales or dividends received. However, trusts that were exempted from filing under the old rules are **now required to file** unless one of a **new set of narrow exceptions** is also met. See some of the more common exceptions in STEP 2 above.

Under the new rules, some of the more **common trusts** that may require disclosure include the following: **trust owning shares of a private corporation**, trust owning a **family cottage**, **spousal or common-law partner trust**, **alter-ego trust** and **testamentary trust**.

New and Expanded Trust Reporting

JANUARY 2024

Failing to File... So what?

Failure to make the required **filings and disclosures on time** attracts penalties of \$25/day, to a maximum of \$2,500, as well as further **penalties on any unpaid taxes**. New **gross negligence** penalties may also apply, being the greater of \$2,500 and **5% of the highest total fair market value** of the **trust's property** at any time in the year. These will apply to **any person or partnership** subject to the new regime.

CRA has recently indicated that, for **bare trusts only**, the **late filing penalty** would be **waived for the 2023 tax year** in situations where the **filing is made after** the due date of **April 2, 2024**. However, CRA noted that this **does not extend** to the penalty applicable where the **failure to file** is made **knowingly** or due to **gross negligence**. As there is limited guidance as to who would qualify, it is recommended that disclosures should be made in a timely manner.

In addition to penalties, failing to properly file trust returns may result in **negative tax** (such as possibly losing access to the principal residence exemption) **and non-tax** (such as inadvertently exposing assets to creditors inappropriately) **consequences**.

If you have any questions, give us a call!

FREQUENTLY ASKED QUESTIONS – BARE TRUST

1. Parent on title of child's home for financing purposes

A parent is on legal title (only has a 1% interest) of their child's home so that the child could qualify for a mortgage. The child is the beneficial owner, and the parent is on legal title only for financing purposes. Would a bare trust arrangement exist? If so, which party would be the settlor, beneficiary and trustee? Would there be one or two trusts if both parents are on title?

If the parent on legal title is only holding the 1% interest in the property for the benefit of their child and they would not receive 1% of the proceeds if the home were sold, then they are likely holding the 1% property in trust for the benefit of their child, and a bare trust arrangement would exist for the 1% of the property. In this case, if the child contributed all the assets to purchase the home, the child would likely be the settlor. As the parent is on title of the home for 1% but has no beneficial ownership of the 1%, the parent would likely be the bare trustee for the 1% of the property. If the child received all the sale proceeds on disposition (i.e., 100% instead of 99%) and was responsible for all the costs associated with party, they would be the beneficial owner of 1% of the property. In that case, the child would also report all the gains of the property's eventual sale (i.e., 100% instead of 99%). Where the same party has more than one role in the bare trust relationship (for example, the child is both the beneficiary and settlor), the child would need to be disclosed separately in each capacity on Schedule 15 of the T3 return. Where two parents are on title of the same property holding the asset in trust for the same beneficiary (their child), there would likely only be one trust with one T3 filing. CRA has not specifically commented on the existence of one or multiple trusts.

2. One spouse on title of family home

Can you elaborate on the concept that where one individual of a spousal unit is on legal title of the family home, there may be a bare trust arrangement?

Where the only spouse on legal title is the sole beneficial owner, there would be no bare trust arrangement and no T3 would be required. However, if the couple views the property as being beneficially owned by both spouses, the spouse on title would be a bare trustee for their partner. The specifics of each scenario must be reviewed on its own merits. To determine if one or both spouses are beneficial owners, consideration should be provided as to who contributed towards the purchase, paid for the expenses, bore liability risk, made decisions in respect to the property and was entitled to income/proceeds of sale from the property (ignoring the spousal attribution rules). The fact that both spouses live in a home does not in and of itself result in both spouses being beneficial owners. If both spouses are true beneficial owners, but only one is on title, then a bare trust arrangement would likely exist. Note that it is possible for creditors to access assets which are beneficially, but not legally, owned by a debtor, such as assets held by a bare trustee.

3. Parent renting property to their child

Would a bare trust arrangement exist if a parent is on title of a property and is the beneficial owner but allows their child to rent or live in the property?

If the children are simply 'using' the property, but the parent is still responsible for paying all the expenses and/or is entitled to all the income (rental income/sale proceeds), no bare trust relationship would exist. The parent has both legal title and beneficial ownership of the property. This also means that the parent would report income and gains on the property's eventual sale. Similarly, the parent might be a partial beneficial owner. For example, a 1% beneficial owner would be entitled to 1% of any income or sale proceeds from the property.

4. In-trust-for bank/investment accounts

Consider a parent holding a bank or investment account 'in-trust-for' their child. Assume that the arrangement triggers a trust filing requirement (for example, the fair market value of the assets exceeds \$50,000 during the year or the account held an asset not including on those permitted for the exception); which party would be the settlor, beneficiary and trustee? Would this change if the parent reported the income under the attribution rules due to the parent gifting the asset to the minor child?

If the parent strictly held the asset for their child's benefit, the parent would likely be the trustee. Provided that the child was entitled to the asset, they would be the beneficiary. The person that contributed the asset to the account would be the settlor. This would require a review of the original contribution. This may be one person or several people. The analysis would not change if the income earned in the account was subject to the attribution rules and reported by a person different from the beneficial owner.

5. Joint bank/investment accounts

Would a bare trust arrangement exist for joint bank/investment accounts?

The specifics of each arrangement must be reviewed on its own merits, including a review of the taxpayer's intention when originally setting up the account and terms of the contract, specific to the account. The legal account holder and beneficial owners of the account must be identified. To determine whether both account holders are also both beneficial owner(s), questions such as the following must be considered: Can both owners use the funds as they please? Do both owners report income from the account on their tax return (ignoring attribution rules)? Would the owners split the funds on the account if the account closes? If the answer to these questions is yes, joint beneficial owners exist. There is no bare trust arrangement if the legal owners and beneficial owners match. If they do not match, the person on legal title (the trustee) would likely hold the account in trust for another person (beneficial owner). Some banks and financial institutions have begun

releasing their views regarding their specific types of accounts. These views typically advise the account holders to obtain tax advice, further highlighting the uncertainties of these determinations. Note that if an individual were added to an account as a joint owner with a corresponding beneficial ownership acquisition, the former beneficial and legal owner of that portion of the account would have disposed of that portion. This may result in reporting of gains/losses on the disposition if the account held investments (rather than just cash).

6. Accounts with a right of survivorship

Would a bare trust arrangement exist where a bank or investment account has a 'right of survivorship' or similar provision?

The specifics of each arrangement must be reviewed on its own merits, including a review of the taxpayer's intention when originally setting up the account and the terms of the contract, specific to the account. If the party holding the asset is both the legal and beneficial owner at that time, then a bare trust arrangement would not likely exist. For example, if the terms of the account stipulate that no one other than the account holder can have legal title or beneficial ownership of the account while the account holder is alive, but upon their death, the legal and beneficial ownership passes to another party, then it could be argued that there is no bare trust arrangement while the individual is alive. This would suggest that only the account holder with legal title and beneficial ownership could initiate transactions on the account during their lifetime. Some banks and financial institutions have begun releasing their views regarding their specific types of accounts. These views typically advise the account holders to obtain tax advice, further highlighting the uncertainties of these determinations.

7. Power of Attorney

Would a bare trust arrangement exist where a child has a power of attorney (POA) on their parents' bank/investment accounts?

The specifics of each arrangement must be reviewed on its own merits. However, if the child is not the legal owner of the asset but has signing authority or the right to conduct operations with a asset under a POA, it would not appear that a bare trust arrangement exists.

8. Corporation holding multiple properties

A corporation is the legal owner holding several properties under separate bare trust arrangements. Each bare trust has its own agreement, as the properties were purchased over several years. Is a T3 tax return required for each separate property? If so, what is the naming convention if each agreement names the same beneficiary (an individual)?

If the same trustee(s) hold assets for the same beneficiary(ies) under the same terms, it seems reasonable to assert that it is a single trust, not multiple separate trusts. However, no legislation or case law provides guidance on whether a series of trust relationships

constitutes a single trust or multiple smaller trusts. CRA suggest that where the bare trust has no documented name, the legal name (e.g., the full corporate name identified in the articles of incorporation, or the first and last names of an individual) of the beneficial owner(s), followed by the word 'Trust' should be used. CRA's suggested naming convention is not mandatory at law. It is entirely possible to have multiple trusts with identical names as, for example, many individuals have the same name. Presumably, CRA will differentiate the trusts using relevant tax identification numbers.

9. Corporate asset that shareholder uses

Would a corporately owned asset (such as a vehicle) that a shareholder uses personally result in a bare trust arrangement? Does it change if the shareholder reports a taxable benefit?

As the corporation is the vehicles legal owner, it must be determined if the corporation is also the beneficial owner or if another party is the beneficial owner. To make such a determination, the following questions should be considered: Whose funds were used for purchase? Who pays for maintenance? Who claims CCA, if available? Who will keep the proceeds after the vehicle is sold? If the corporation is the beneficial owner, there is no bare trust arrangement. This may occur, for example, when employees are provided with a company car in which they have no actual ownership interest. A legal and beneficial owner allowing another person to use their asset (whether or not for compensation) would no generally result in a trust relationship. If the individual is the beneficial owner, there is likely a bare trust arrangement. The same analysis should be conducted even if the individual reports a taxable benefit.

10. Corporation on title, but shareholder is beneficiary

Suppose a corporation is the beneficial owner of an asset, but its shareholder is on title of the asset. Why would a bare trust arrangement exist if the corporation and the shareholder are the same?

As a corporation is a separate legal entity, different from its shareholders, either one could hold property in trust for the other. If a corporation is a beneficial owner of an asset (i.e. pays the purchase price and/or expenses, earns income, is entitle to sale proceeds, pays tax on income/gain), but the shareholder is on legal title of the asset, a bare trust relationship would exist.

11. Corporation transfers asset to shareholder

Consider the scenario where a corporately held asset (e.g., a truck) was transferred to the shareholder's name as it was beneficial for insurance purposes. Would a bare trust arrangement exist?

It must be determined as to whether the shareholder or the corporation was the beneficial owner of the truck. Who pays for maintenance? Who claims CCA deductions? Who will keep the proceeds when the truck is sold? If it is the shareholder, there is no bare trust

arrangement as the legal title is consistent with the beneficial ownership. In this case, a lease agreement between the shareholder and the corporation for the lease of the truck should document the arrangement. If the transfer of the truck from the corporation to the shareholder represented a change in beneficial ownership, the disposition by the corporation must be properly reported, including consideration of any income tax, GST/HST and provincial sales tax issues. If the corporation is the beneficial owner, there is a bare trust relationship as the shareholder holds the legal title to the truck for the benefit of the corporation.

12. Who must file the T3?

*Is the trustee, settlor or beneficiary responsible for filing the trust return?
The trustee(s) is responsible for filing the trust return.*

13. Should we delay filing?

As many matters related to the expanded trust reporting rules (particularly bare trust arrangements) are unclear, would you suggest that we delay filing bare trust T3 returns, including Schedule 15? By doing so, we can incorporate any clarification subsequently released into our bare trust filings.

CRA's penalty relief states that for bare trusts only, the late filing penalty would be waived for the 2023 tax year in situations where the filing is made after the due date of April 2, 2024. However, CRA noted that this does not extend to the penalty applicable where the failure to file is made knowingly or due to gross negligence. This penalty is the greater of \$2,500 and 5% of the fair market value of the trusts property. The application of CRA's announced penalty relief rests in their discretion, and they have included several caveats. The client will need to decide whether they are comfortable assuming the risk of penalty if they do not comply with the filing requirements set out in the Act.