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Finance proposes to reduce the scope of the enhanced trust reporting rules

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In brief

On August 12, 2024, the Department of Finance released draft legislative proposals (the proposals) to implement numerous 2024 federal budget and other measures. The proposals include significant amendments to the enhanced trust reporting rules that would reduce the number of trusts, including "bare trust" arrangements, that would need to file:

- a T3 "Trust Income Tax and Information Return," and
- Schedule 15, "Beneficial ownership information of a trust,"

starting with taxation years ending after December 30, 2024. This includes only requiring bare trust arrangements to have a filing obligation for taxation years ending after December 30, 2025, effectively deferring their filing obligations by one year. The amendments also create a new stand-alone definition of a "settlor," for the purposes of Schedule 15, that may reduce the scope of persons that need to be reported.

This *Tax Insights* provides an overview of the proposed changes to the trust reporting rules, including details of the expanded list of excluded trusts. Interested parties are asked to provide comments to the Department of Finance on these amendments by September 11, 2024.

In detail

Background

In December 2022, enhanced tax return filing and information reporting requirements for trusts with a taxation year ending after December 30, 2023, as well as penalties for non-compliance with these rules, were enacted federally.[1] These enhanced rules also created a requirement for bare trusts to file a T3 return and Schedule 15 in certain cases; however, on March 28, 2024, the Canada Revenue Agency (CRA) announced that they would not require bare trusts to file a T3 return, including Schedule 15, for the 2023 tax year, unless the CRA makes a direct request for these filings, and that they would work with the Department of Finance to clarify its guidance on this filing requirement.

Overview of the proposed rules

The Department of Finance has stated that the proposals released on August 12, 2024 are to clarify the "bare trust reporting rules to significantly reduce the number of Canadians with bare trusts who would have to file, and ease the related administrative burden." In addition to the complete exclusion of bare trusts from their filing obligations for 2024, key proposed changes, which impact both bare trusts and other trusts, effective for taxation years ending:

[1] For more information on the currently enacted enhanced trust reporting rules, see our *Tax Insights* "Enhanced reporting rules for trusts and bare trusts: Trustees – are you ready?" (March 28, 2024 update) at www.pwc.com/ca/taxinsights.

- after December 30, 2025, establish new rules that reduce the number of bare trusts that will be subject to the enhanced trust reporting rules
- after December 30, 2024:
  - increase the threshold for small trusts to be excluded from the enhanced trust reporting rules
  - create a new stand-alone definition of “settlor,” for the purpose of completing Schedule 15

The proposals also provide a number of technical fixes and other adjustments that should reduce the number of trusts subject to the enhanced trust reporting rules.

Bare trust arrangements

Current rules

The enhanced reporting rules apply to a bare trust arrangement that is a resident of Canada and is an express trust, or for civil law purposes a trust (other than a trust established by law or by judgement). Before 2023, a bare trust did not have a T3 return filing obligation, and Schedule 15 was not introduced until 2023.

For purposes of the trust reporting rules, “a trust includes an arrangement under which a trust can reasonably be considered to act as agent for all the beneficiaries under the trust with respect to all dealings with all of the trust’s property” (commonly known as “bare trust” arrangements).

According to the CRA, a trustee can reasonably be considered to act as agent for a beneficiary when:

- the trustee has no significant powers or responsibilities and can take no action without instructions from that beneficiary, and
- the trustee’s only function is to hold legal title to the property

For the trustee to be considered as the agent for all the beneficiaries of a trust, it would generally be necessary for the trustee to consult and take instructions from each and every beneficiary with respect to all dealings with all of the trust property. The rules do not provide any exclusions that are specific to bare trusts; to be excluded from the reporting rules, a bare trust would need to rely on an exception that is available to all trusts.

Proposed rules

The proposals repeal the current rules that bring bare trusts under the scope of the enhanced trust reporting rules for the taxation year ending after December 30, 2024. The proposed new regime for bare trusts would be effective for taxation years ending after December 30, 2025, providing a one-year exemption for bare trusts to be subject to the filing requirements.

The proposed new regime deems certain bare trusts to be express trusts for purposes of the enhanced trust reporting rules when the following conditions are met:

- one or more persons have legal ownership of property that is held for the use of, or benefit of, one or more persons or partnerships (each person that is a legal owner is treated as a “trustee”), and
- the legal owner can reasonably be considered to act as agent for the persons or partnerships who have the use of, or benefit of, the property (each person or partnership that has the use or benefit of property is treated as a “beneficiary”)

However, certain bare trust arrangements that meet the above conditions will not be deemed an express trust if any of the following exceptions apply:

- each legal owner of a property is also deemed a beneficiary in respect of that property and there are no legal owners that are not deemed to be beneficiaries
- the legal owners are related individuals and the property is real property that could be designated as a principal residence by one or more of the legal owners for the year (but need not be so designated)

- the legal owner is an individual and the property is held for the use of, or benefit of, the legal owner's spouse or common-law partner during the year, and it could be designated as a principal residence by the legal owner for the year (but need not be so designated)
- the property is held for the use of, or benefit of, a partnership, and the following conditions apply:
  - each legal owner is a partner (other than a limited partner) of the partnership, and
  - a member of that partnership is required to file a partnership information return in respect of that partnership for a taxation year that includes December 31 of that year
- the legal owner holds the property pursuant to a court order
- the property held under the arrangement is a "Canadian resource property," and it is held solely for the use of, or benefit of, a corporation listed on a designated stock exchange or certain corporations or partnerships that are controlled by such corporation or in which such corporation has a majority interest
- the property is held exclusively for the use of, or benefit of, one or more specific persons (generally charities and not-for-profit organizations [NPOs]), and the following conditions apply:
  - each legal owner is a specific person (generally charities and NPOs), and
  - the property consists solely of funds received from the Crown

PwC observes

The carve-outs that exclude certain bare trusts from being deemed an express trust should significantly reduce the number of bare trusts that are required to file under the currently enacted rules. The targeted carve-outs would remove a bare trust filing requirement for many arrangements where the taxpayer may have already reported information about the arrangement to the CRA in another form (e.g. a partnership information return).

The proposed extension to implement the bare trust reporting requirements by one year is welcomed, as it should give both taxpayers and the CRA more time to understand and consider any nuanced scenarios that may arise and seek clarification. Trustees will now have until the end of 2024 to consider whether a bare trust arrangement should be wound up to avoid creating a tax filing obligation.

Small trust exception

A trust that meets the small trust exception is not required to complete Schedule 15. In addition, a trust that meets the small trust exception that has no income tax payable, no taxable capital gains and no dispositions of capital property in the year is also not required to file a T3 return.

Current rules

The current rules provide a small trust exception for a trust that only holds certain assets with a maximum aggregate fair market value (FMV) that does not exceed $50,000 throughout the year (these assets are limited to money, certain debt obligations, interests in mutual funds or segregated funds, and listed securities).

Proposed rules

The proposed rules, which are effective for taxation years ending after December 30, 2024, create the following two types of small trust exceptions:

- a trust that holds any assets with an aggregate FMV that does not exceed $50,000 throughout the year
- a trust that holds certain assets with an aggregate FMV that does not exceed $250,000 throughout the year, but only if:
  - each trustee and beneficiary is an individual and each beneficiary is related to each trustee, and
  - the only assets held consist of one or more of:
    - money, certain debt obligations, guaranteed investment certificates (GICs), interests in mutual funds or segregated funds, and listed securities

- personal-use property of the trust
- the right to receive income on the assets described above

PwC observes

Trusts with assets that do not exceed $50,000 in the year would have greater flexibility on the assets that can be held; however, trustees would need to exercise caution if those assets include private company shares because their value may not be ascertainable at all times during the year.

The increased threshold of $250,000 for certain trusts in conjunction with expanding the listed assets to include GICs, personal-use property and the right to receive income (e.g. dividends on public company shares) should significantly expand the number of trusts that would qualify for the small trust exception.

Settlor definition

Current rules

The term "settlor" is defined to include a person or partnership who has loaned property or transferred property, directly or indirectly in any matter whatever, to or for the benefit of the trust at or before the taxation year end, but excludes:

- loans made at a reasonable rate of interest, and
- transfers made for FMV consideration,

by a person or partnership dealing at arm's length at the transaction time.

Proposed rules

The term "settlor" is proposed to be defined as a "person or partnership that has directly or indirectly, in any manner whatever, transferred property to the trust at or before that time, other than a transfer made by the person or partnership to the trust for fair market value consideration or pursuant to a legal obligation to make the transfer."

PwC observes

The proposed change to the definition should help narrow the scope of settlors that would need to be reported on Schedule 15. For example, a loan to a trust may no longer result in a person being a settlor, nor would transfers of property made for FMV consideration by non-arm's length persons. Trustees will need to consider how to proceed if they had reported a person as a settlor previously, but who would no longer be a settlor under the proposed rules.

Other proposals

The proposals also include:

- providing the following new situations where a trust would not need to file a Schedule 15, and in certain cases, there would be no need to file a T3 return:
  - a trust that is established for the purpose of complying with a Canadian or provincial statute for a specific purpose
  - a lawyer's separate trust account that does not exceed $250,000 in the year (an exception under the current rules for a lawyer's general trust account of any amount will continue to apply)
- making a partnership a reportable entity for purposes of Schedule 15
- clarifying that only one Schedule 15 is required for each trust
- ensuring that trusts that are registered charities do not need to file a T3 return even if they dispose of capital property in the year

The takeaway

The proposed changes to the enhanced trust reporting rules would reduce the scope of these rules and therefore lessen the required tax compliance. The proposals respond to the concern that the currently enacted rules may have been more broad than intended. These proposals appear to provide a solution for many of the typical scenarios when there was a potentially unexpected filing obligation, such as certain arrangements arising in a partnership, “in-trust” accounts and joint account arrangements below a certain threshold, and family members being listed on family homes merely to facilitate a purchase without retaining beneficial ownership or for probate planning purposes.

Although the proposals address many challenges, there are still concerns with these rules; for example, when a trustee does not have all the information on their reportable entities for reporting on Schedule 15 because the information is unobtainable.

Let’s talk

For a deeper discussion of how these proposed new rules impact your trust arrangements and trust reporting requirements, please contact your PwC adviser or:

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