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Tax Alert — Canada

New Canadian trust reporting requirements to impact many foreign trusts

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.

Legislative amendments enacted in December 2022 resulted in new Canadian reporting requirements for many trusts — including certain foreign trusts with ties to Canada.

In this Tax Alert, we provide a brief overview of the new requirements and how they may impact nonresident trusts.[1] Under the new reporting requirements, those nonresident trusts that historically had to file an annual tax return will now have additional disclosure obligations. In addition, many nonresident trusts that were previously not required to file an annual tax return will now have a filing obligation in Canada.

The new rules apply for taxation years ending after 30 December 2023. For trusts impacted by these requirements, the first filing deadline under the new rules will be 30 March 2024.[2]

[1] For more information on the history of these amendments, see EY Tax Alert 2022 Issue No. 4, *Proposed trust additional reporting requirements*, EY Tax Alert 2022 Issue No. 37, *Finance releases draft legislation for remaining 2022 budget measures* and EY Tax Alert 2022 Issue No. 45, *Bill C-32 to implement certain Budget 2022 and other previously announced measures receives Royal Assent*.

[2] However, since 30 March 2024 occurs on a Saturday, the filing deadline is administratively deferred to the next business day, 2 April 2024.

Building a better working world

New rules: When does a nonresident trust have to file?

Prior to the new requirements, a nonresident trust would typically have to file an annual tax return — the T3 Trust Income Tax and Information Return (T3 return) — only if:

- It was deemed resident in Canada and had income taxable in Canada in the year;
- It had disposed of taxable Canadian property[3] in the year; or
- It carried on a business in Canada in the year.

Under the new rules, most trusts that are either factually resident in Canada or **deemed resident** in Canada (discussed below) are now required to file a T3 return every year, regardless of whether the trust has tax payable in Canada or disposed of any property, with limited exceptions.

As discussed below, foreign trusts may potentially be subject to these new rules when one or more of the following apply:

- A person who is, or was, a resident of Canada transferred or loaned property to the trust;
- A Canadian resident is a beneficiary of the trust;
- The trust holds taxable Canadian property; or
- The trust carried on business in Canada in the year.

Certain trusts will be exempt from the new reporting requirements, including (but not limited to):

- Trusts that have been in existence for less than three months at the end of the year;
- Trusts that hold $50,000 or less in cash or designated near-cash assets throughout the year; and
- Certain estates.

[3] In simplified terms, taxable Canadian property is property that is, or derives its value principally from, real property situated in Canada or is an asset used in a business carried on primarily in Canada.

Deemed resident trusts

The new rules apply not only to trusts that are factually resident in Canada but also to trusts that are deemed resident in Canada.

A trust will generally be considered factually resident in the jurisdiction where the central management and control of the trust actually takes place. However, certain otherwise nonresident trusts may nonetheless be deemed resident in Canada and subject to tax in Canada on part or all of their worldwide income. The deemed resident trust rules are complex and require careful analysis of all the facts and circumstances surrounding a trust. Broadly speaking, a trust is deemed to be resident in Canada where there is either a "resident contributor" or a "resident beneficiary".

A resident contributor is a Canadian-resident person who has made a "contribution" to the trust. "Contribution" is broadly defined to include a wide variety of scenarios, including certain direct and indirect transfers and loans to the trust.

For example, consider an individual, Mrs. A, who currently lives in the US but is planning to become resident in Canada for tax purposes. Prior to becoming resident in Canada, Mrs. A made a contribution to a US trust. At the time Mrs. A becomes a resident of Canada, the US trust will have a resident contributor and will be a deemed resident trust from the beginning of the year in which Mrs. A became a Canadian resident for tax purposes.

A "resident beneficiary" is generally a Canadian-resident person that is, at a given time, a beneficiary under the trust and there is a "connected contributor" to the trust at that time. A "connected contributor" is generally a person who made a contribution either while resident in Canada or within 60 months of moving to or leaving Canada.

For example, consider an individual, Mr. B, who lives in Canada with his children but is planning to move permanently to the US. If within 60 months of leaving Canada, Mr. B establishes a US-domiciled trust for the benefit of his Canadian-resident children, that trust will be deemed resident in Canada from the beginning of the year in which Mr. B made a contribution to the US trust.

Bare trusts

One of the most significant changes is that the new reporting requirements will apply to so-called "bare trusts". A bare trust includes an arrangement where the trust can reasonably be considered to act as agent for its beneficiary(ies) with respect to all dealings in all the trust's property. Prior to 31 December 2023, bare trusts were effectively excluded from the T3 return filing requirement; however, under the new rules, a bare trust will be required to file an annual T3 return unless an exemption applies. Indeed, under the expanded requirements, many other informal trust and agency relationships may now require an annual T3 return, such as an in-trust account set up by a parent for a child.

Bare trusts are often used in real estate transactions or as part of probate planning. For example, for estate planning or administrative purposes, legal title to a Canadian vacation property might be registered in the name of a nominee corporation or a trustee, even though the beneficial and economic ownership is held by another individual or entity. This bare trust relationship will now need to file a T3 return, provided the bare trust is resident, or deemed resident, in Canada.

Expanded disclosure requirements

The new reporting requirements significantly expand the information that must be disclosed with the T3 return. Under the new rules, trusts have to report the identity of and include certain prescribed information for all trustees, beneficiaries and settlors of the trust, as well as 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 in a year (e.g., a protector of the trust). The required information includes the name, address, date of birth, jurisdiction of residence and taxpayer identification number in respect of these persons. In addition, information must be included regarding any beneficiaries that cannot be listed by name (e.g., unborn children and grandchildren) because they are unknown at the time of filing the T3 return. A new beneficial ownership schedule, T3 Schedule 15, *Beneficial Ownership Information of a Trust*,[4] has been added to the T3 return to report the required information.

Notably, the definition of "settlor" for these purposes includes any person or partnership that has loaned or transferred property, directly or indirectly in any manner whatever, to or for the benefit of the trust. This definition may be broad enough to capture individuals who undertook common Canadian tax and estate planning strategies, such as an estate freeze, or those who loaned even a nominal amount of money to a trust with which they do not deal at arm's length.

Penalties for non-compliance

New penalties apply to any person or partnership that is subject to the additional reporting requirements and who fails to file a T3 return as required. These penalties are 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 also applies if a false statement or omission is knowingly made in the return or made under circumstances amounting to gross negligence. For Québec tax purposes, the 2021 Québec 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.

[4] The Québec version of T3 Schedule 15 is Part 6 and Schedule G of the TP-646-V Québec income tax return.

On 1 December 2023, the Canada Revenue Agency (CRA) announced that it will provide temporary administrative relief to bare trusts. More specifically, the CRA has announced that it will waive the late-filing penalty[5] for the 2023 taxation year for bare trusts that file their T3 return and Schedule 15 after the 30 March 2024 filing deadline. The CRA noted that it is providing this administrative relief since this is the first taxation year in which bare trusts will have a T3 filing requirement as a result of the new reporting requirements. The CRA also stated that this relief only applies to the 2023 taxation year, and if the failure to file by the applicable deadline is made knowingly or due to gross negligence, the new penalty provision noted above may apply.

Other considerations

(Deemed) disposition of taxable Canadian property

As noted above, in many cases, a nonresident trust that disposes of taxable Canadian property in the year must file a T3 return and pay tax on any resulting gains. It is important to note that this requirement also applies to any deemed dispositions for Canadian tax purposes.

Under the Canadian income tax system, most trusts are deemed to dispose of their worldwide assets at fair market value 21 years from the date the trust is created and every 21 years thereafter. This applies equally to trusts that are resident in Canada and nonresident trusts, regardless of where the trust assets are located. Where the trust holds taxable Canadian property, the trust will be deemed to dispose of that property at fair market value every 21 years, triggering Canadian income tax on any accrued net capital gains.

A similar fair market value deemed disposition may occur when a trust distributes property — including taxable Canadian property — to a beneficiary who is a nonresident of Canada.

Accordingly, foreign trusts with Canadian real property or business assets may have a tax liability and T3 return filing obligation arising from this so-called "21-year deemed disposition". For 2023 and later taxation years, the T3 return must also include the new beneficial ownership information required to be disclosed on Schedule 15.

New alternative minimum tax rules

In addition to the new reporting requirements, trusts with taxable income in Canada may also have to contend with new proposed rules pertaining to the alternative minimum tax (AMT). The proposals apply for taxation years beginning after 2023. Under the proposals, certain trusts that distribute all their net income in the year to beneficiaries may nonetheless have AMT payable. The proposed rules may present a problem for certain trusts, especially where the trust's terms do not permit it to retain income.

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[5] The late-filing penalty is imposed under subsection 162(7) of the *Income Tax Act*.

Next steps

The new reporting requirements will apply to many foreign trusts that previously did not have a tax filing requirement in Canada. Trustees should consider whether any of the following risk factors apply to them:

- The trust holds taxable Canadian property;
- A person who is, or was, a resident of Canada transferred or loaned property to the trust; or
- A Canadian resident is a beneficiary of the trust.

If any of these factors apply, trustees should consult with their tax advisors to determine if the new reporting requirements apply to them.

Learn more

For more information on the new trust reporting requirements or the proposed amendments to the AMT regime, please contact your EY or EY Law tax advisor or one of the following professionals:

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