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TAXSTRATEGY

(Not so) New

Trust Reporting Rules

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So, I'm going to ask you to think way, way, way, back, to a time before face masks and online schools. When we would go to a crowded concert or packed restaurants without thinking twice about it. The year is 2018 (some of you may think this was not that long ago, but these past two years feels like 20 years, so I stand by my assertion that 2018 feels like a lifetime ago).

In the 2018 federal budget, the government announced the introduction of new reporting requirements for Canadian trusts. And as you may recall from previous articles, under the Tax Act in Canada, a trust is a separate taxable entity, which means that it is a taxpayer in its own right and has to report any income and pay taxes on that income (to the extent it has not allocated any income out in the same taxation year to a beneficiary). This means a trust has to also file a tax return, based on a December 31 year end. But unlike individuals, a trust has to file its tax return (known as a T3) within 90 days of its year end, meaning March 30.

Up until now, filing a T3 has not usually been a large deal. For those that value privacy, the information to be disclosed as it relates to the trust itself (other than its income) was relatively simple. The trustee, name of the trust and address had to be disclosed. If the trust distributed any assets, the beneficiary that received the asset had to be listed. If there was a change to the beneficiaries, that had to be disclosed and the name of the new beneficiary had to be listed. But otherwise, the information disclosed was not too onerous.

That Was Then

However, the 2018 Budget announced that for 2021 and subsequent tax years, additional information will be required on trust T3 (for both domestic and non-resident trusts that are deemed resident). Specifically, disclosure is to be made for all trustees, beneficiaries and settlors (including anyone who is able to exert control over trustee decisions in relation to allocations of trust income or capital, such as a Protector), even if a beneficiary didn't receive a distribution. This requirement is in respect of "express trusts."

So, what is an express trust? Although the Tax Act does not actually provide a definition for an express trust, it would appear based on common law and legal textbooks that an express trust would be one that is deliberately created. So, this would appear to capture all discretionary family trusts. Certain trusts are excluded, including graduated rate estates, qualified disability trusts, non-profit trusts and registered charities or trusts that are less than three months old or that generally holds less than $50,000 worth in assets throughout the year (provided that the assets do not include shares of a private company or real estate).

For all other trusts, (includ-

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ing a typical discretionary family trust) that hold value more than $50,000, then you no longer have the privilege of complete privacy. So, if you formed a discretionary trust where you included everyone but the family dog as a discretionary beneficiary, the disclosure requirements may well cause a large headache for you. What if your class of beneficiaries include contingent beneficiaries? How do you determine who needs to be part of the disclosure? Well it appears that the new proposed rules provided that the requirement to disclose includes all beneficiaries, including contingent beneficiaries, whose identity is known or ascertained with reasonable effort by the person who is filing the return for the trust.

Another change that was announced was that even if a trust had no income payable in the year, it will be required to file a T3 (currently, the general rule was that a trust didn't have to file if there was no income payable in the year).

And to reinforce these new rules, new penalties will be introduced for failure to file a T3 with the proper disclosure information ($25 a day with a minimum of $100 and a maximum of $2500). If the failure to file was made knowingly or due to gross negligence, there is an additional penalty of 5 per cent of the maximum fair-market value of the property held (with a minimum penalty of $2500). This latter penalty can end up being quite punitive if a family trust is sitting on shares of a company that has significant value.

However, there was much confusion among tax practitioners as to how these rules were to be applied back in 2018, without much clarity since no legislation had actually been introduced by the government. And then back on January 14, 2022, the government announced they were going to defer the application of the new disclosure rules as the legislation in respect of these new disclosure rules is still pending. This meant that the CRA will continue to administer the existing rules for trusts and that proposed enhanced beneficial ownership reporting will not be required for the 2021 tax year. .

And then, not even a month later, the government dropped their draft legislation on February 4, 2022 as part of a larger set of new rules to implement various measures announced in the 2021 Federal Budgets.

This Is (Possibly) Now

The draft legislation as it related to the trust disclosure rules included the following (in addition to the above noted changes first introduced in 2018):

☛ disclosure of information on a T3 return, including Beneficial Ownership and Control Information, is not required if the information is subject to solicitor-client privilege;

☛ 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 referred to as a "bare trust") is now explicitly subject to the new trust filing and reporting rules. This is a big change, as bare-trust arrangements have never been required to file T3 returns. This have a huge effect on the real estate industry as it is common to have a bare-trust corporation hold title to real estate for a third-party beneficiary for various reasons (creditor protection, financing issues and planning act issues to name a few).

☛ Under the original release in 2018, certain types of trusts were exempted from the new reporting requirements, such as mutual fund trusts, segregated funds, master trusts and trusts governed by registered plans. However, investment funds organized as trusts that did not qualify as "mutual fund trusts" were not exempt. However, the new 2022 draft legislation now exempts trusts, all the units of which are listed on a designated stock exchange (this includes trusts that, though publicly listed, are not widely held enough to qualify as mutual fund trusts).

The 2022 draft legislation also confirmed that the new reporting rules will be applicable for taxation years of trusts that ended after December 30, 2022. And since trusts are required to have a December 31 year end, this means that the new rules will apply for the T3s that are due for 2022 (and therefore the filing deadline will be March 30, 2021).

The key word throughout my article is that this is still DRAFT legislation. The government is taking comments from the public in respect of the various pieces making up the February 4 draft rules, and the deadline for comments relating to the new trust reporting requirements is April 5, 2022. So it will be interesting to see what comments are submitted and how the government will react. My gut tells me that there won't be any lack of submissions.

If you turned 71 this year, you must close your Registered Retirement Savings Plan, or RRSP, by December 31. You'll face three options. It's important to weigh the investment and tax implications of all three.

Cashing it in will raise your income tax

One option is to cash in your RRSP. The trouble is, you'll likely pay the top tax rate on this 'income'—giving the taxman much of the RRSP money you saved over a lifetime. But cashing in your RRSP can make sense if you need cash to, say, make home improvements and you already have an adequate pension. It can also make sense if you're in a low-income year.

A second option is to buy annuities with cash from your RRSP. That is, you transfer cash tax-free to a life insurer which guarantees you a series of future payments. You should opt for inflation protection. That way, inflation won't erode the value of these payments. This dependable income lets you plan your retirement. We recommend annuities to 'top up' your pension income if it's insufficient to meet your living costs.

High interest rates can hurt annuities

If you plan to buy annuities, shop around. Some life insurers pay more than others. Also, make sure your annuity income from a life insurer is at most $2,000 a month. That way, if the insurer fails, your income is fully covered by industry-funded Assuris. If you want more than $2,000 a month, buy annuities from more than one life insurance company.

Just remember that low interest rates usually result in lower annuity payments. Interest rates are now rising. Particularly as central banks seek to use higher interest rates to reduce inflation. You might decide to delay putting a lot of your money into annuities until interest rates are substantially higher.

Plan ahead

If you plan to cash in your RRSP or withdraw cash to buy an annuity, it's critical to plan ahead. Make sure your RRSP holds short-term or maturing bonds. Avoid stocks and long-term bonds to fund your withdrawals. Selling at the wrong time can cause unnecessary losses. Also, rearrange and defer other income so you declare the RRSP proceeds in a year when you'd otherwise be in a low tax bracket. Even better, make the cash withdrawals from the RRSP over a few years, keeping other taxable income to a minimum. Make sure that you have maturities in each of those years to supply the cash.

The third option is to convert your RRSP into a Registered Retirement Income Fund, or RRIF. A RRIF essentially continues your RRSP with one big difference—you withdraw money each year instead of contributing. As a result, you need not have bonds mature before the conversion date. Still, you should gradually arrange your portfolio so that some bonds mature in each future year to fund your required withdrawals. But minimum required withdrawals have dropped.

Convert your RRSP into a RRIF.

RRIFs are popular. They offer some advantages over annuities and we usually advise you to convert at least part of your RRSP to a RRIF. You keep managing your money and build the RRIF so that the minimum withdrawals, based on the RRIF's value, grow and offset inflation.

If you opt for a RRIF, invest defensively: you can't replace losses in a RRIF. The only hope of recovery is through capital gains from your remaining portfolio, which provides an incentive to take on even more risk. Remember also that your minimum withdrawals will vary as the portfolio fluctuates, making planning more difficult. RRIFs remain a sound option, but mainly if you're prepared and able to manage your own money. ❑