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CHANGES TO TRUST REPORTING RULES WILL SERIOUSLY AFFECT CHARITIES, CLARITY NEEDED

By Terrance S. Carter, Theresa L.M. Man, Jacqueline M. Demczur & Lynne M. Westerhof[*]

A. INTRODUCTION

It had been previously reported that changes to the new trust reporting provisions in the *Income Tax Act* ("ITA") introduced in late 2022 may affect charities, such that charities that hold internal trusts that are set up as express trusts (such as internal endowments) might be required to file an annual return of income for each trust.[1] It was not clear at that time whether the legislation was intended to apply to internal trusts held by charities, and, if not, whether subsequent changes to the ITA might be made to clarify that intention.

However, following recent discussions and correspondence that two of the authors had with senior officials at the Department of Finance ("Finance") and the Canada Revenue Agency ("CRA"), it is now clear that the legislative intent of the new trust reporting requirements is to include express internal trusts held by charities. This is a significant development for the charitable sector. In response, this Bulletin reviews the new trust reporting requirements, how charities will be impacted, and the urgency for the CRA

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[1] See Terrance S. Carter, Jacqueline M. Demczur & Theresa L.M. Man, "Draft Budget Implementation Legislation Will Increase DQ And Affect Trust Reporting" *Charity & NFP Law Bulletin No. 515*, (24 August 2022) online: *Carters Professional Corporation* <https://www.carters.ca/pub/bulletin/charity/2022/chylb515.pdf> and, by the same authors, "Bill C-32 Will Increase DQ, Affect Trust Reporting, and Make Other Changes to the Income Tax Act" *Charity & NFP Law Bulletin No. 517*, (23 November 2022) online: *Carters Professional Corporation* <https://www.carters.ca/pub/bulletin/charity/2022/chylb517.pdf>.

to provide clarity to the charitable sector before these rules come into force for trusts with taxation years that end after December 30, 2023.

B. NEW TRUST REPORTING RULES

By way of background, trusts are required to file an annual income tax return, the *T3 Trust Income Tax and Information Return* ("T3"), within 90 days of the end of its taxation year. However, there are a number of statutory and administrative exceptions to this filing requirement. Trust filings involve complicated rules, which are outside the scope of this Bulletin. Prior to the new trust reporting rules, generally, a trust only has to file a T3 for a taxation year if: it earns taxable income and it has income tax payable; it has disposed of capital property; it has realized a taxable capital gain; or it makes a distribution of all or part of its income, gains or capital to one or more of its beneficiaries.

After originally being proposed in 2018 and again in 2022,[2] new trust reporting requirements were finally added to the ITA as part of Bill C-32, the *Fall Economic Statement Implementation Act, 2022*,[3] which received Royal Assent on December 15, 2022. Under the new rules, express trusts (or, in the civil law context, a trust that is not established by law or judgment) and bare trusts will be required to file T3s for taxation years that end after December 30, 2023. Specifically:

- Subsection 150(1) sets out the tax return requirements and the filing dates for different categories of taxpayers. Trusts are required under paragraph 150(1)(c) to file a return within 90 days from the trust's tax year end.

- Subsection 150(1.1) sets out exceptions to subsection 150(1), where the filing of a tax return is not required. For example, incorporated registered charities are exempt from filing corporate tax returns under paragraph 150(1.1)(a).

[2] Trust reporting changes were originally announced in the Federal Budget of February 27, 2018, and proposed draft legislation and regulations on these new rules were released on July 27, 2018. The draft rules were included in a set of draft legislative proposals from the Department of Finance released on February 4, 2022, delaying the implementation of the proposed rules by one year, applicable to taxation years ending after December 31, 2022, instead of December 31, 2021 taxation year as previously proposed, as well as other changes to the proposed rules. Several months later, on August 8, 2022, the Department of Finance again included the proposed new rules in draft legislation, with some minor changes. Finally, the trust reporting changes were included as part of Bill C-32, which received Royal Assent on December 15, 2022.

[3] Bill C-32, *Fall Economic Statement Implementation Act, 2022*, 1st Sess, 44th Parl, 2022 (assented to 15 December 2022).

- Subsection 150(1.1) is now amended to make it subject to new subsection 150(1.2). New subsection 150(1.2) provides that the exceptions under subsection 150(1.1) do not apply to an express trust (or for civil law purposes a trust other than a trust that is established by law or by judgement) that is resident in Canada, unless the trust meets one of the exceptions listed in new paragraphs 150(1.2)(a) to (o). Registered charities and non-profit organizations under paragraph 149(1)(l) are exempted under paragraphs 150(1.2)(d) and (e). However, the exceptions do not, on the face of the wording, apply to internal trusts held by registered charities where the trusts are set up as express trusts (such as endowment funds set up by a deed of gift by donors imposing trust terms on the donated funds). Other exceptions in new paragraphs 150(1.2)(a) to (o) include trusts that hold less than $50,000 in assets throughout the taxation year (provided that their holdings are confined to deposits, government debt obligations and listed securities). Concerns involving the application of the new trust reporting requirements to internal trusts are reviewed below in this Bulletin.

- New subsection 150(1.3) also subjects bare trusts to the new trust reporting requirements. These include "an arrangement where a trust can reasonably be considered to act as agent for its beneficiaries with respect to all dealings in all of the trust's property." It is important for charities and non-profit organizations that have entered into bare trust arrangements to be aware of the application of the new filing requirements. Details and concerns involving bare trusts are outside of the scope of this Bulletin.

- Trusts that are required to file a return will also be required to provide additional information set out in new section 204.2 of the *Income Tax Regulations* (ITR). This additional information includes the name, address, date of birth (in the case of an individual other than a trust), jurisdiction of residence and taxpayer identification number (or TIN, as defined in subsection 270(1) of the ITA) for each person who, in the year, (a) is a trustee, beneficiary or settlor (as defined in subsection 17(15) of the ITA) of the trust; or (b) has the ability (through the terms of the trust or a related agreement) to exert influence over trustee decisions regarding the appointment of income or capital of the trust. Subsection 270(1) of the ITA defines "TIN" ("taxpayer identification number") to mean "(a) the number used by the Minister to identify an individual or entity, including (i) a social insurance number, (ii) a business number, and (iii) an account number issued to a trust; and (b) in respect of a jurisdiction other than Canada, a taxpayer identification number

used in that jurisdiction to identify an individual or entity (or a functional equivalent in the absence of a taxpayer identification number)."

- To ensure compliance with the trust reporting requirements, under new subsections 163(5) and (6), a person who knowingly or under circumstances amounting to gross negligence fails to file a return for a trust would be subject to a severe penalty that is the greater of (a) $2,500 or (b) 5% of the highest amount of the total fair market value of all the property held in the trust at any time in the taxation year. The penalty also applies to any person who knowingly or under circumstances amounting to gross negligence either makes — or participates in, assents to or acquiesces in, the making of — a false statement or omission in the return. It also applies to anyone who fails to comply with a demand order from the CRA to file a T3.

The penalty for non-compliance with the new trust reporting requirements is harsh. For example, an express trust that holds $2 million in property in a taxation year ending on December 31, 2023, could be subject to a $100,000 penalty if a T3 is not filed, or if the T3 does not contain all of the required information. Presumably, this penalty is in addition to any potential penalties set out in subsections 162(1) (failure to file return of income), 162(2) (repeated failure to file), 162(3) (failure to file by trustee), 163(1) (repeated failure to report income), and 163(2) (false statements or omissions) of the ITA.

C. APPLICATION TO INTERNAL TRUSTS HELD BY CHARITIES

The new rules apply to express trusts unless the trusts meet one of the exceptions in paragraphs 150(1.2)(a) to (o). The term "express trust" is not defined in the ITA. The CRA accepts that an express trust is generally a trust created with the settlor's express intent, usually made in writing (as opposed to a resulting or constructive trust, or certain trusts deemed to arise under the provisions of a statute).[4]

Registered charities and non-profit organizations are included in the list of exemptions in paragraphs 150(1.2)(d) and (e). This would refer to registered charities and non-profit organizations that are *organized* as trusts. Although the 2022 Federal Budget and the explanatory notes to the proposed rules released in

[4] See CRA, "T3 Trust Guide – 2022" (date modified 17 February 2023), online: *Government of Canada* <https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/t4013/t3-trust-guide.html#P181_16897> ["T3 Guide"]; and CRA "Reporting Requirements for Trusts" (date modified 10 January, 2023), online: *Government of Canada* <https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/federal-government-budgets/budget-2018-equality-growth-strong-middle-class/reporting-requirements-trusts.html>.

2018 and 2022 indicate that these two exemptions apply to "trusts that *qualify* as non-profit organizations or registered charities," [emphasis added] this is not the wording of the language in the amended ITA.

As indicated above, the exemptions under paragraphs 150(1.2)(d) and (e) do not, on the face of the wording, apply to internal trusts held by registered charities where the trusts are set up as express trusts. Many charities hold property in trust – by way of examples: (a) an endowment may be subject to restrictions on how it may be used, or how long the capital is to be held; or (b) a gift to set up a scholarship may be subject to restrictions on who may receive the scholarship and the amount of each scholarship. Furthermore, it is possible that a charity may hold numerous internal trusts at any time.

1. Past CRA Administrative Policy for Internal Trusts

If the new trust reporting rules will require internal trusts of charities to file separate trust returns, it would be a reversal of a longstanding CRA administrative policy of not requiring internal trust funds held by charity to be separately registered as charities under the ITA.

Internal trusts are generally created by donors as special purpose charitable trusts. A special purpose charitable trust is often also referred to as a "donor restricted trust fund", a "charitable trust property", a "special purpose fund", an "endowment fund", or a "restricted fund."

Subsection 104(2) of the ITA provides that a trust is deemed to be an individual and therefore has to file a tax return and pays tax as a separate person. However, we received confirmation from senior policy officials at the Policy, Planning & Legislation Division of the Charities Directorate of the CRA in April 2013, that the CRA did not require internal trusts of registered charities to be separately registered as charities or to file separate trust returns.

Specifically, the CRA referred to the meaning of the term "restricted funds" on their website, and this definition remains the same today on their website:[5]

> **Restricted funds**
> Restricted funds are funds tied to a specific use and not available for the general purposes of the organization (for example, a fund consisting of contributions that donors specifically direct the registered charity to use to buy a new building). Endowments are one type of restricted fund. Donors create them when they

[5] CRA "Charities and giving glossary"(date modified 3 December 2018), online: *Government of Canada* <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/charities-giving-glossary.html>.

> stipulate that the registered charity must maintain the principal amount and only use the income earned on it.

In comparison, the CRA directed us to its former policy on "restricted funds" (Summary Policy CSP-R22: Restricted Fund, which was released in 2003 and revised in 2005), which the senior policy official indicated had been removed by the CRA in order to "reduce duplicative content … because similar content already exists in the Glossary":

> **Former Summary Policy:**
> Restricted funds are funds tied to a specific use and not available for the general purposes of a registered charity. Donors create them when they stipulate that the charity must maintain the principal amount and only use the interest earned on it (e.g., endowment to establish a scholarship fund).

The CRA confirmed that "it can be understood that the CRA does not see that there is any prohibition in the *Income Tax Act* precluding a charity from having such a restricted fund and consequently does not require a charity to register such a fund as a separate registered charity."

Therefore, by way of analogy, internal restricted funds held by charities are not required to file separate trust returns even though a trust is deemed under the ITA to be an individual and therefore would otherwise have to file a trust return.

2. Recent Response from Finance and the CRA

Two of the authors, on behalf of a client, have sought clarification from Finance and the CRA as early as 2020 on the application of new trust reporting rules to internal funds held by registered charities that are set up as express trusts. After repeated follow up requests, the authors recently heard back from senior officials from Finance and the CRA and the responses are concerning.

During a conversation in May 2023 with a senior official at the Department of Finance, we were advised that the intent of the legislation is to require all internal express trusts of charities to file separate trust returns with the CRA. The senior official indicated that it is now up to the CRA to determine how to require charities to comply with the new trust reporting rules, which are now mandatory under the ITA despite the CRA's longstanding past administrative policy.

The senior official from Finance also explained that these new trust reporting requirements are part of the Federal Government's commitment to gather financial information on trusts in accordance with protocols

from the Organization for Economic Cooperation and Development. The fact that all internal trusts held by charities are already included in the charities' financial statements and T3010 *Registered Charity Information Return* was of no concern to Finance. Similarly, the fact that tax-exempt entities in the United States are not required to file separate returns for internal trusts was also of no concern. When issues about the extent of new information that will be required to be reported (such as TINs of settlors and beneficiaries) were raised, that also was of no concern to Finance. Instead, the senior official indicated that this information is readily available to charities and the reporting should be rather straight forward. The senior official also indicated that there is still a lot of time for charities to comply with these new requirements, since the reports are not required until sometime in 2024.

This past month (June 2023), two of the authors have also heard back from a senior official from the Policy, Planning & Legislation Division of the Charities Directorate that the new trust reporting rules will indeed "create challenges for registered charities that have multiple internally-held trusts and/or limited access to the information required to complete an information return." The senior official also indicated that the Charities Directorate would "monitor and assess how the new rules affect registered charities," but the "implementation will be managed by the CRA area responsible for T3 returns." The senior official then made reference to the CRA's webpage on "Reporting Requirements for Trusts" concerning the new trust filing requirements for the broader trust sector.[6]

D. ISSUES WITH NEW REPORTING REQUIREMENTS

The application of the new trust reporting rules to internal trust funds held by charities that are set up as express trusts raises many issues for the charitable sector. It is anticipated that these issues could result in what may be an administrative hardship for many charities by requiring them to expend charitable resources on unnecessary and pointless compliance requirements in order to avoid the application of very serious penalties. Below are some key issues.

1. Are Internal Express Restricted Charitable Purpose Trust Funds "Express Trusts"?

In order for the new trust reporting rules to apply, internal trusts held by charities would need to be "express trusts" as referred to in section 150 of the ITA.

[6] T3 Guide *supra* note 4.

At common law, an express trust is created when a settlor "clearly and specifically says that certain property is to be held in trust."[7] The intention of the settlor can be expressed by "oral or written words" that may "state quite clearly that certain property is to be subject to a trust." In other words, an express trust can be established orally or in writing. An express trust can be contrasted with an implied trust which arises when the settlor's language has to be construed in order for its legal meaning to be discovered (*i.e.*, the settlor does not clearly and specifically say that certain property is to be held in trust).[8]

Similarly, the courts have held that "[a]n express trust is one in which the person creating it has expressed his or her intention to have property held by one or more persons for the benefit of another or others."[9] It is important that the settlors' intentions are clearly stated, as elsewhere the courts have stated that "[e]xpress trusts are those which come into existence because settlors have declared their intention to that effect."[10] There are a variety of ways in which a settlor can indicate their intentions to create an express trust, such as through "contract, will, or oral and written declarations."[11]

As explained above, the term "express trust" is not defined in the ITA. The CRA accepts that an express trust is generally a trust created with the settlor's express intent, usually made in writing (as opposed to a resulting or constructive trust, or certain trusts deemed to arise under the provisions of a statute).[12] In this regard, the CRA takes the view that "[a]n express trust is generally described as one where the person creating it (the settlor) has expressed his or her intention to have property held by one or more persons (the trustees) for the benefit of one or more persons (the beneficiaries)."[13]

As such, internal trusts that are created expressly by donors would meet the definition at law to be "express trusts." In this regard, internal trusts are often created expressly by donors as special purpose charitable trusts. A special purpose charitable trust is created at common law when a donor gifts property to be held "in trust" for a specific charitable purpose rather than for the general charitable purposes of the charity (such as a gift to support the education of nursing students at a university, as opposed to a gift for the

[7] Donovan WM Waters, Mark R Gillen, and Lionel D Smith, *Waters' Law of Trusts in Canada*, 5th ed. (Toronto: Thomson Reuters Canada, 2021) at 2.I "Express, Implied, Resulting, and Constructive Trusts".
[8] *Ibid*.
[9] *Great-West Life Assurance Co. v. The Queen*, 1998 CanLII 326, 1998 CarswellNat 1478 (TCC) at para 49, citing DWM Waters, *Law of Trusts in Canada*, 2nd ed. (Carswell, Toronto, 1984) at p 15.
[10] *Caplan v. Minister of National Revenue*, 1986 CanLII 7528, 1986 CarswellNat 413 at para 18.
[11] *Canada v. Canada North Group Inc.*, 2021 SCC 30 at para 118.
[12] T3 Guide, *supra* note 4.
[13] CRA Document, 9832537, "Disposition—probate and income tax issues," (11 March 1999).

general educational charitable purposes of the university). Where a donor's intention is clear, an express special purpose charitable trust is created. In that case, the charity is, in effect, managing a sub-charity within its own charity. As indicated above, a special purpose charitable trust is often also referred to as a "donor restricted trust fund", a "charitable trust property", a "special purpose fund", an "endowment fund", or a "restricted fund."[14]

Because the term "express trust" is not defined in the new trust reporting requirements, it would therefore appear, on the face of the wording in new subsection 150(1.2), that express restricted charitable purpose trust funds held by charities would constitute "express trusts" and thereby be caught by the new reporting requirements. As explained above, this understanding and approach has now been confirmed in discussions with Finance and correspondence with the CRA. However, the new requirements lack policy rationale and will have serious negative ramifications on the charitable sector as explained further below.

Depending on the circumstances and documentation under which a donor advised fund ("DAF") is established, it is also possible that some DAFs may also be caught by the wording in the new subsection 150(1.2). A DAF is a type of charitable giving vehicle that is established when a fund is created by a donor through an initial donation of capital to a registered charity, with or without restrictions, and the donor has the unique role of being able to make non-binding recommendations to the charity about the distribution of assets from the DAF over to other registered charities. When – at the time the DAF is established and the initial gift is made – a donor imposes express restrictions on the DAF that are over and above the general direction that the gift be held in the DAF (*e.g.*, restrictions about the length of time the capital is to be held, or restricting the purposes for which funds are to be used), these restrictions could make the gift into a restricted charitable purpose trust.[15]

[14] For a detailed explanation of the special purpose charitable trust, please refer to an article by Terrance S. Carter, "Donor-Restricted Charitable Gifts: A Practical Overview Revisited II", (2006) *The Philanthropist* Vol. 18 No. 1 & 2, online: <https://www.carters.ca/pub/article/charity/2006/tsc0421.pdf>. See also Jane Burke-Robertson, Terrance S. Carter, & Theresa L.M. Man, "Chapter 19: Issues in Drafting Restricted Charitable Purpose Trusts", *Corporate and Practice Manual for Charities and Not-for-Profit Corporations* (Thomson Reuters Canada Limited, 2023).

[15] Jacqueline M. Demczur, "Primer on Donor Advised Funds and Current Issues – Revisited" (paper delivered at the CBA Charity Law Symposium 2023, Toronto ON, 12 May 2023), online: *Carters Professional Corporation* <https://www.carters.ca/pub/seminar/charity/2023/Paper-Primer-on-Donor-Advised-Funds-and-Current-Issues-Revisited-2023-05-12.pdf>.

2. Broad Application

The new trust reporting requirements will have a significant impact on the charitable sector because they will apply broadly across charitable foundations (both public and private) and charitable organizations. All internally held express trust funds that are subject to donors' restrictions will have to comply with the new reporting requirements. This would include, for example:

- all express restricted charitable purpose trusts from donors requiring the gifts be used for certain purposes, such as research, humanitarian projects or scholarships;

- all express restricted charitable purpose trusts from donors requiring the gifts be held subject to time restrictions, such as endowments;

- donor advised funds that are established subject to express terms of trust (as explained above); and

- gifts of real property that are made subject to the terms of an express trust or are conveyed by means of a trust deed.

For some charities, such as community foundations and universities, it is possible that they may have hundreds, if not thousands, of internally held express trust funds, each of which would have to file a separate T3 annually. In addition, there are over 120,000 DAFs in Canada,[16] and it is possible that some of these might be subject to the new trust reporting rules.

Further, unincorporated religious organizations that hold properties under deeds of trust (for example pursuant to the Ontario *Religious Organization Lands Act*) might be caught by these new trust reporting requirements, despite a lack of coherent policy rationale for the same reasons.

3. Extent of Information to be Filed

As mentioned above, ITR 204.2(1) requires that T3s include information about trustees, beneficiaries, and settlors of a trust, as well as anyone who has the ability to exert influence over trustee decisions. ITR

[16] "Influence, Affluence & Opportunity: Donor-advised Funds in Canada" (paper delivered at the CAGP's 29th National Conference on Strategic Philanthropy, Vancouver BC, 19-21 April 2023) Ketchum Canada Inc. and Canadian Association of Gift Planners at p. 8, 11. Note that 102,000 of these donor advised funds were reported by a single foundation, Charitable Impact.

204.2(2) recognizes that not all beneficiaries of a trust may be known at the time of filing and, therefore, provides certain examples of when the reporting requirements will be deemed to have been met, such as where information is provided in respect of each beneficiary "whose identity is known or ascertainable with reasonable effort."

However, charities could face many challenges obtaining information about trustees, beneficiaries, and settlors of a trust, as well as anyone who has the ability to exert influence over trustee decisions. The following are some examples:

- Charities may have difficulty obtaining information about settlors, such as a taxpayer identification number for endowments established by a settlor many years ago, or a settlor's address for restricted funds set up as a result of a bequest from an estate gift under a will. Even with current donors, they may be reluctant to provide their social insurance number or their date of birth to charities. As a result, asking for such personal information may serve as a deterrence for donors in establishing express trusts with charities and, consequently, could result in a negative impact on charitable giving to the sector.

- Another example would be if a charity was to ask the public to donate to the charity for a specific purpose. It is not clear if this might result in each donor being caught by the new trust reporting rules, meaning that the charity might need to provide their social insurance number or their date of birth in the trust return.

- It is not clear who will be identified as a person who has the ability to exert influence over trustee decisions, either through the terms of the trust or a related agreement – would this include, for instance, individuals who set up DAFs and who provide suggestions as to how the funds are disbursed, notwithstanding how such individuals do not retain control over the gifts they make to these funds?

4. Lack of Policy Rationale

As indicated above, the senior official at Finance explained that these new trust reporting requirements are part of the Federal Government's commitment to gather financial information on trusts in accordance with protocols from the Organization for Economic Cooperation and Development ("OECD").[17]

As such, the new trust reporting rules are intended to create public transparency for personal trusts in accordance with OECD directives. It is not clear why express internal trusts of charities should also be subject to the same trust reporting when the trust funds are already disclosed in the financial statements and T3010 of the charities that hold them.

By way of background, the underlying policy rationale for the new trust reporting rules was mentioned briefly as early as the 2017 Federal Budget, being the Government's intention to implement "strong standards for corporate and beneficial ownership transparency that provide safeguards against money laundering, terrorist financing, tax evasion and tax avoidance…" by "examining ways to enhance the tax reporting requirements for trusts in order to improve the collection of beneficial ownership information."[18]

In a News Release by Finance on December 11, 2017, entitled "Agreement to Strengthen Beneficial Ownership Transparency," it indicated that Finance Ministers agreed on the importance of ensuring appropriate safeguards are in place to prevent the misuse of corporations and other legal entities for tax evasion and other criminal purposes, such as money laundering, corruption and the financing of terrorist activities.[19] The "Backgrounder: Tax Fairness and Beneficial Ownership Transparency" for the News Release indicated that strengthening beneficial ownership reporting is required to address blind spots in the Federal Government's obligation under legislation passed to "adopt the Common Reporting Standard, and signed on to the Organisation for Economic Cooperation and Development (OECD)'s Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting."[20]

[17] See *e.g.* "Building Effective Beneficial Ownership Frameworks: A joint Global Forum and IDB Toolkit" (2021), online: *Organisation for Economic Co-operation and Development (OECD) and the Inter-American Development Bank* <https://www.oecd.org/tax/transparency/documents/effective-beneficial-ownership-frameworks-toolkit_en.pdf>.
[18] "Building a Strong Middle Class" Budget 2017 (22 March 2017), online: *Government of Canada* <https://www.budget.canada.ca/2017/docs/plan/budget-2017-en.pdf> at p. 213.
[19] "Agreement to Strengthen Beneficial Ownership Transparency" (date modified 11 December 2017), online: *Government of Canada* <https://www.canada.ca/en/department-finance/programs/agreements/strengthen-beneficial-ownership-transparency.html>.
[20] "Backgrounder: Tax Fairness and Beneficial Ownership Transparency" (date modified 11 December 2017), online: *Government of Canada* <https://www.canada.ca/en/department-finance/news/2017/12/backgrounder_taxfairnessandbeneficialownershiptransparency.html>.

Then, the 2018 Federal Budget indicated that new trust reporting rules are required to "determine taxpayers' tax liabilities and to effectively counter aggressive tax avoidance as well as tax evasion, money laundering and other criminal activities" as follows:

> Authorities require sufficient information in order to determine taxpayers' tax liabilities and to *effectively counter aggressive tax avoidance as well as tax evasion, money laundering and other criminal activities. Some taxpayers have used trusts in complex arrangements to prevent the appropriate authorities from acquiring this required information.*
>
> A trust that does not earn income or make distributions in a year is generally not required to file an annual (T3) return of income. A trust is required to file a T3 return if the trust has tax payable or it distributes all or part of its income or capital to its beneficiaries. Even if a trust is required to file a return of income for a year, there is no requirement for the trust to report the identity of all its beneficiaries. Given the absence of an annual reporting requirement, and the limitations with respect to the information collected when reporting is required, there are significant gaps with respect to the information that is currently collected with respect to trusts.
>
> As a consequence, Budget 2017 announced the Government's intention to examine ways to enhance the tax reporting requirements for trusts in order to improve the collection of beneficial ownership information.
>
> *… This information would be used to help the Canada Revenue Agency assess the tax liability for trusts and its beneficiaries.* [21] [Emphasis added]

However, requiring internal express trusts of Canadian charities to file separate trust returns appears to go beyond what similar legislation adopted by some other OECD countries requires. For example, the United States has a *Corporate Transparency Act* which imposes beneficial ownership information reporting requirements on "reporting companies."[22] Notably, a "reporting company" does *not* include a charity or similar entities (described as a 501(c) organization under the US Internal Revenue Code) or a charitable trust (as described in paragraph (1) of section 4947(a) of the US Internal Revenue Code).[23] In the United Kingdom, funds held on trust by or on behalf of a charity for the purposes of that charity (referred to as "special trusts") are *not* required to register with the country's Trust Registration Service "provided that

[21] "Equality + Growth: A Strong Middle Class" Budget 2018 (27 February 2018), online: *Government of Canada* <https://www.budget.canada.ca/2018/docs/plan/budget-2018-en.pdf>.
[22] *Corporate Transparency Act*, Subchapter II of chapter 53 of title 31, USC § 5336(b)(1)(B)
[23] *Ibid* § 5336(a)(11)(B)(xix)(I) and (III). See also IRC §501(c) and § 4947(a)(1).

they are accounted for as part of the accounts and annual reports of a charity that is a registered charity" or the accounts and annual reports of a charity excluded from registration by legislation.[24]

Since all internal trusts held by charities are already included in their financial statements and T3010s, the additional information that the new trust reporting requirements intend to gather from these internal trusts seemingly serves no purpose whatsoever for the beneficial ownership transparency objective.

Presumably, if more detailed information is indeed required for policy reasons, it would be much more efficient to simply ask for this information in the context of a charity's T3010, rather than through separate T3 trust returns. Unfortunately, this is not what the new trust reporting rules require. The current wording in the ITA also does not appear to permit the CRA to administratively require information on express internal trusts held by registered charities be included in their T3010s.

Further, as explained above, registered charities and non-profit organizations that are *organized* as trusts are exempt from the new trust reporting rules under paragraphs 150(1.2)(d) and (e). This means that the current reporting by registered charities (in T3010s) and non-profit organizations (in T2s, *T1044 Non-Profit Organization (NPO) Information Return*, and T3s for non-profit organizations whose main purpose is to provide dining, recreational, or sporting facilities, and earn income from property) are sufficient filings for beneficial ownership transparency purposes. Given that charities and non-profit organizations that are organized as trusts are not required to file T3s under the new trust reporting rules, there is no policy reason why express internal trust held by them should be subject to the new trust reporting requirements.

E. URGENT NEED FOR CLARITY FROM THE CRA

Given the issues identified above, it will be extremely important to hear from the CRA regarding how it plans to administer the new trust reporting requirements passed into law with Bill C-32. This is especially urgent and concerning given the position of Finance that Bill C-32 is intended to include internal express trusts held by charities. As has explained above, the scope of these new provisions is broad, the

[24] "HMRC internal manual: Trust Registration Service Manual" (updated 25 May 2023), online: *GOV.UK* <https://www.gov.uk/hmrc-internal-manuals/trust-registration-service-manual/trsm23060>.

information to be reported may be difficult (and sometimes impossible) for charities to obtain, and the lack of rationale to apply these new rules to internal express trusts of charities is highly problematic.

Furthermore, and equally significant, the filing deadline is quickly approaching. For trusts with a taxation year ending after December 30, 2023, the deadline is as early as March 30, 2024 (because 2024 is a leap year). Trusts generally have a December 31 tax year-end, subject to a few exceptions.[25] This would seem to apply to express internal trusts caught by the new trust reporting rules. This would mean that the T3 required for the internal express trusts would have to be based on a December 31 year end, even if the charities that that hold these internal express trusts have an off-calendar year end (such as March 31, June 30, or September 30), adding further confusion and administrative burden for the charitable sector.

As well, it is not clear whether charities that hold multiple internal express trusts would have to file separate T3 for each internal express trust, rather than filing one T3 for all internal express trusts held. Without clarification from the CRA, the default may be that each internal express trust would be required to file separate T3s.[26]

Given the severe penalty for failing to file the required T3 or not providing all information required in the return, it is not possible for charities to take a wait-and-see approach. Considerable preparation time will be required by affected charities to ensure compliance with these new reporting requirements, including understanding the details and application of the rules, reviewing records to determine what express trusts means, determining whether any of the internal trust funds held by them are express trusts and if they have all the necessary information under the new T3s, etc. This will also include charities having to consult legal and accounting advisors because they will likely never have filed any trust returns before. Since the vast majority of charities have December 31 year end, it is anticipated that impact of this new filing requirement will hit the charitable sector as a huge administrative challenge at an already very busy time of the year for charities.

Considering that this is already June 2023, time is of the essence for clarity be provided by the CRA. It took two of the authors three years to hear back from Finance and the CRA regarding the application of

[25] CRA, "Tax year-end and fiscal period" (date modified 21 December 2022), online: *Government of Canada* <https://www.canada.ca/en/revenue-agency/services/tax/trust-administrators/tax-year-end-fiscal-period.html>.
[26] This is based on the language in the T3 Trust Guide – 2022 which generally refers to the filing of a T3 for a singular "trust" as opposed to plural "trusts." See T3 Guide, *supra* note 4.

these new rules. It is concerning to hear from the senior Finance official in May 2023 that there is still a lot of time for charities to comply with these new requirements, since the reports are not required until sometime in 2024. The time, effort, complexity, and the work that will be required for charities to comply with the new reporting requirements are apparently not understood, and seriously underestimated by the government.

Given the language of the new trust reporting requirements in the ITA, it is not clear whether the CRA will have the option to continue its past administrative policy to exempt internal trusts to file separate returns, or to incorporate the new trust reporting requirements as part of the T3010. As well, the indication by the CRA that implementation of the new trust reporting lies with the Division in the CRA responsible for T3s, and not with the Charities Directorate, is also very concerning, potentially leaving the charitable sector as orphans to be bounced between different Divisions within the CRA system.

In light of all of the concerns articulated above, it is hoped that the CRA will provide clear information regarding trust reporting obligations as soon as possible, so that charities are given sufficient time to understand and process the new reporting requirements and ensure they are able to comply with them.