

Your Estate Planning May Be Creating Unintended Tax Reporting Obligations

Has a parent added you as a joint owner to a bank account to assist them in managing their finances? Have you participated in any other arrangement where an asset is registered in your name, but held for the benefit of someone else? If so, you could be the trustee of a bare trust, and you may be obligated to comply with new Canada Revenue Agency tax reporting requirements.

Bare trusts have generally been exempted from the requirements to file income tax returns (a “T3 Return”) that are otherwise applicable to many trust arrangements. Under the expanded reporting regime introduced by Bill C-32, however, trustees of bare trusts will now be required to file T3 Returns and disclosure forms for taxation years ending on or after December 31, 2023. Trustees who fail to comply with this new requirement will potentially face significant penalties.

Basics of a Bare Trust

A trust describes the fiduciary obligation that arises in relationships where a person (a “trustee”) is required to hold certain property separate from her own, for the benefit of one or more persons or entities (the “beneficiaries”).

In a bare trust the trustee is merely vested with legal title and has no independent duties or powers with respect to the trust property. The trustee’s sole responsibility is to deal with the property as the beneficiary directs. The beneficiary retains the full beneficial ownership of the property in question, and, as a result, the income and gains realized on the trust property are taxed in the beneficiary’s hands.

The Reporting Rules

Under the current rules, a trustee of a bare trust is generally only required to file a T3 Return if the trust has income tax payable or disposes of capital property in the year. Bare

trusts often avoid this requirement as the income generated from the trust property is taxed directly to the beneficiary.

Under the new rules, a trustee of a bare trust must file a T3 Return on an annual basis regardless of whether there is income to report. The trustee must also file a Schedule 15 Beneficial Ownership Information of a Trust form¹ setting out identification information for all trustees, beneficiaries, settlors, and protectors of the trust. The trustee must include the name, address, date of birth, jurisdiction of residence, and taxpayer identification number or social insurance number for each such person or entity identified.

During the 2023 STEP/CRA roundtable, the CRA was asked whether “beneficiary” includes contingent beneficiaries in disaster clauses who are entitled to share in trust property only upon the death of the primary beneficiaries. The CRA stated that generally, a beneficiary includes any person who “has a right to compel the trustee to properly enforce the terms of the trust, regardless of whether that person’s right to the income or capital of the trust is immediate, future, contingent, absolute, or conditional on the exercise of discretion by any person....”²

The beneficiaries in bare trust arrangements will generally be few and easily discernible. However, the disaster beneficiaries in family trust agreements are often broad classes of remote family members, such as nieces or nephews, whose interests are contingent on the deaths

of all primary beneficiaries, generally encompassing all lineal descendants of a particular family member or member(s). In such cases, trustees will need to navigate the requirement to solicit personal information, including social insurance numbers, from potentially unfriendly contingent beneficiaries who are unaware they are beneficiaries of a family trust.

Bare Trusts in Joint Ownership Arrangements

For purposes of the new reporting requirements, a bare trust is defined as any arrangement “under which [the trustee] 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”.³

The government’s definition is broadly applicable to principal-agent relationships involving trust property. There is no requirement that the agreement to hold property as a bare trustee must be reduced to writing, nor is there a requirement that the agreement between the parties be explicit. Conduct implying a principal-agent relationship in the holding of trust property will be sufficient.

Arrangements commonly used to facilitate estate planning appear to be captured. For example, joint ownership arrangements are often utilized by parents and children for various reasons. Consider the following examples where an individual employs a joint ownership structure for estate planning purposes:

- A parent adds a child as joint owner of a bank account to enable the child to assist with bill payments and other banking matters on the parent’s behalf. Both parties recognize that the assets in the account are to be used solely for the parent’s benefit.
- A parent adds her only child as joint tenant on title to her home but does not gift the child the right of survivorship. The parent continues living in the home and paying all associated costs. The parent’s other assets are all nominal in value, and the child is the sole beneficiary of the parent’s Will. On the parent’s death, probate is not required to deal with any asset, and the estate avoids the Estate Administration Tax that otherwise would have been charged with respect to the home.
- A parent adds one of her three children as joint owner of a bank account. The parent does not intend that the child receive the value of the account on her death to the exclusion of the other children. Rather, she simply

wishes for her estate to have faster access to liquidity to pay debts.

Each of the above relationships could be characterized as a child holding legal title to an asset, but having no duties or powers beyond dealing with the property as the parent instructs. Each example appears to be captured by the enhanced reporting requirements, and in each case the child may be obligated to file a T3 Return, and report identification information of the participants in the arrangement to the Canada Revenue Agency.

Joint ownership arrangements are prevalent in estate planning for their convenience, ease, low-cost, and minimization of probate fees. Where the goal is assisting someone in their financial affairs, joint ownership may be viewed as a convenient alternative to appointing an attorney for property under a power of attorney. When individuals seek to minimize probate fees, a jointly owned account may be viewed as more cost-efficient than a formal Alter-Ego Trust.

Unfortunately, joint ownership arrangements are often carried out with little thought or documentary support. In many instances, an individual may be unaware that they have become a bare trustee and are subject to reporting obligations.

Bare Trusts in Other Common Scenarios

Other common arrangements between family members may also be subject to the new reporting requirements. For example:

- Funds deposited into an “in-trust” account by an individual (trustee) for the benefit of a minor family member. In an in-trust arrangement, the minor (beneficiary) is entitled to collapse the account and receive all funds upon turning 18.
- A child purchases a home but requires the parents to be added to the mortgage application. In such arrangements, the parent would generally also be added to the title as a joint owner.

Penalties

Failure to comply with the filing requirements will result in significant penalties. If the trust fails to meet the filing timelines, it will be subject to a penalty of \$25 per day, with a minimum penalty of \$100 and a maximum of \$2,500.

Moreover, if the trust does any of the following, there will be a new, additional penalty, equal to the *greater* of \$2,500 and 5% of the maximum value of property held by the trust during the year:

- Fails to file a return knowingly or due to gross negligence;
- Includes a false statement, or omits to include any required information, knowingly or due to gross negligence; or
- Fails to respond to a CRA demand to file.

The new penalty can apply without regard to the significance of the error or omission in question. Accordingly, it is important that bare trustees be able to demonstrate that they have made efforts to comply with the new reporting and disclosure requirements.

Caution: Joint Ownership Arrangements in Estate Planning Are Not Without Risk

While joint ownership can often be a simple and effective means of accomplishing estate planning objectives, it is equally as often fraught with pitfalls. Failure to document intentions and unexpected issues can lead to unintended consequences and costly litigation.

Example: “A” is a widow. He has two children, “B” and “C”. A’s will divides his estate equally between B and C, with gift-overs to their respective children. A’s sole asset is his home. B lives at the home, without charge, but provides some assistance to A. Shortly before his death, A adds B to title of the home as a joint tenant.

Three of the possible outcomes are as follows:

- **Option 1:** A gifted B the right of survivorship in the home to B. B is added to title as a joint tenant.
Result: B receives the home as surviving joint tenant.
- **Option 2:** B holds legal title as a bare trustee for A. On A’s death, B holds legal title as a bare trustee for A’s estate.
Result: the home is divided evenly between A and B pursuant to the Will. Probate fees may or may not be avoided.
- **Option 3:** A and B are true joint tenants with the right of survivorship. A intends B to immediately receive a 1/2 beneficial interest in the home.

Result: transfer of the home may constitute a disposition. There may be capital gains tax liability on the accrued gains, subject to principal residence exemption. B receives the home as joint tenant with right of survivorship.

B will argue Option 1 and C will argue Option 2. Even if the parties evidenced their intention in writing, the joint ownership structure could result in unintended consequences.

For example, assume A intended that B receive the entire home on A’s death by gift of the right of survivorship. Perhaps A and C’s relationship had deteriorated, and/or A wished to provide for his less financially secure son, B, and B’s family. Rather than executing a new Will, A instead resolves to use a joint ownership structure, hoping to also avoid probate fees. The potential issues:

- **Order of Death** – If B dies before A, then A will again become the sole owner. On A’s death, his estate, including the house, is divided in accordance with his Will, 50% to C and 50% among B’s children. A’s intention to disproportionately benefit B’s family and disinherit C is therefore thwarted.
- **Reduced Control** – Sometime after adding B to title, A wishes to sell the home and move into a retirement facility. B refuses to consent to the sale. A is required to bring litigation against B to sell the home.
- **Probate Required** – A fails to execute the appropriate documentation to establish a gift of the right of survivorship to B. B is deemed to hold the beneficial interest in home in trust for A’s estate. A has other assets that require probate to be dealt with. Even if B were the sole beneficiary of A’s estate, unless A executed multiple Wills, B would be required to include the home in the probate application and pay the applicable Estate Administration Tax.
- **Income Tax Consequences** – If A is deemed to have added B to title as a true joint tenant with right of survivorship, immediately sharing beneficial interest in the home, the transaction will be a disposition. A will be deemed to have sold 1/2 of his interest in the home to B at the current fair market value. If the home has accrued capital gains and does not benefit from the principal residence exemption, A will have immediate capital gains tax liability.

- **Land Transfer Tax** – Assume the same example as above, but the home is also subject to a \$500,000 outstanding mortgage. Land Transfer Tax may be owing on the consideration, deemed to be 1/2 of the outstanding mortgage. If the property is in Toronto, Land Transfer Tax will be \$4,450.

The new trust reporting requirements serve as a further potential complication in joint ownership arrangements.

These risks inherent in such arrangements underscore the need for careful consideration in structuring estate plans.

¹ <https://www.canada.ca/en/revenue-agency/services/forms-publications/forms/t3sch15.html>

² 2023 STEP Roundtable, Q.4

³ *Income Tax Act*, ss. 150(1.3) [Not yet in force]



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