

Budget 2024

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How should trusts flow out capital gains to beneficiaries in 2024?

Trusts must disclose pre- and post-June 25 gains or face negative tax consequences

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Trusts may have extra accounting to do this year thanks to the higher capital gains inclusion rate (CGIR).

Personal trusts that flow out capital gains to beneficiaries this year must disclose which gains were realized before or after June 25, when the CGIR increased to two-thirds from half.

This means any trust that realized a gain between Jan. 1 and June 24 — known as Period 1 — but hasn't yet flowed that gain to beneficiaries can still have the Period 1 gain be subject to the 50% CGIR.

“It's a good approach to the problem,” said Kenneth Keung, director of Canadian tax advisory with Moodys Tax in Calgary. “The trust can just allocate its [Period 1] gains at the end of the year and the beneficiary still gets the benefit [of Period 1 tax treatment].”

However, according to guidance published by the Canada Revenue Agency (CRA) last month, if a trust fails to make the disclosure, then all gains realized in 2024 and designated to beneficiaries on or after June 25 will be deemed to have been realized in Period 2: the period between June 25 and Dec. 31.

That would make the gain taxable in the beneficiary's hands at the two-thirds CGIR if the beneficiary was above the \$250,000 threshold for individuals.

Fortunately, most trusts should be able to distinguish which gains were realized in which period, Keung said. Trusts can obtain information regarding securities sold during 2024 from brokerages, and trustees would already have information related to the sale of a significant asset, such as a business.

The CRA said trusts would have to disclose the gains information to beneficiaries “in prescribed form,” but didn't provide further details. Keung said the CRA may adapt the 2024 T3 Statement of Trust Income Allocations and Designations to require Period 1 and Period 2 reporting of gains.

Generally, a trust can designate its net taxable capital gains for a year to beneficiaries at the trust's year end (Dec. 31, in most cases).

Gains that aren't flowed to beneficiaries are taxable to the trust. Generally, trusts pay tax at the highest marginal rate.

The federal government's 2024 budget proposed increasing the CGIR to two-thirds for trusts and corporations, but individuals would benefit from a \$250,000 annual threshold under which the CGIR would remain 50%. The new CGIR took effect June 25.

In a June 10 notice of ways and means motion, the government addressed the technicalities of how trusts should handle gains realized prior to June 25 but allocated to beneficiaries after that.

For 2024, a trust would gross up the designated amount of its net taxable capital gains by double for gains in Period 1 and by 3/2 for gains in Period 2, thereby reversing the application of the inclusion rates for the trust for each period. (For example, \$66.67 in taxable capital gain realized by the trust in Period 2 would be grossed up to the original \$100 capital gain.)

Assuming the trust does the proper disclosure, the beneficiary would be taxed on the designated capital gain according to the period in which the trust realized it. The trust would then claim a deduction for the taxable capital gain.

Exceptions

Graduated rate estates and qualified disability trusts, which are trusts created on the death of an individual, can access the \$250,000 annual threshold for capital gains otherwise only available to individuals.

Meanwhile, mutual fund trusts and other commercial trusts have two options for flowing out gains to unitholders in 2024.

They can either make an election that the deemed capital gains allocated to investors have been realized by them proportionally within Period 1 and Period 2 or they can disclose to investors the exact underlying capital gains incurred in Period 1 and Period 2.
