April 5th, 2022

Department of Finance
Attn: Honourable Chrystia Freeland
90 Elgin Street
Ottawa, ON
K1A 0G5

By email to: Consultation-Legislation@fin.gc.ca

Dear Minister Freeland,

Enclosed is our submission on certain proposed changes contained in the Legislative Proposals Relating to *Income Tax* Act and Other Legislation together with the Backgrounders on i) Mandatory Disclosure Rules and ii) Income Tax Mandatory Disclosure Rules Consultation: Sample Notifiable Transactions released on February 4, 2022, relating to, *inter alia*, the Avoidance of deemed disposal of trust property. Given that the STEP membership represents a broad cross-section of professional advisors operating in the estate planning and wealth management and preservation fields, the STEP executive believes our comments may be of assistance to you.

Several members of the STEP Canada Tax Technical Committee participated in discussions concerning our submission and contributed to its preparation, in particular:

Kenneth Keung (Moodys Tax)
Ian Lebane (TD Wealth)
Ian Pryor (Pryor Tax Law)
Sebastien Demarais (TD Wealth)
Yogesh Bhathella (KPMG Canada)

We would be pleased to discuss our comments with you at your convenience.

Yours very truly,

Maureen Berry
Co-Chair of Tax Technical Committee
Fasken Martineau DuMoulin LLP

Ian Lebane
Co-Chair of Tax Technical Committee
TD Wealth

**SUBMISSION: LEGISLATIVE PROPOSALS ON NOTIFIABLE TRANSACTIONS RELATIING TO AVOIDANCE OF DEEMED DISPOSAL OF TRUST PROPERTY RELEASED FEBRUARY 4, 2022**

The Society of Trust and Estates Practitioners (Canada) ("**STEP**") is pleased to provide you with this submission in response to certain legislative proposals pertaining to the mandatory disclosure of notifiable transaction rules contained in proposed section 237.4 of the *Income Tax Act*. STEP has a number of comments with respect to these proposals and appreciates the opportunity to share them with the Department of Finance ("**the Department**"). STEP represents a large body of Canadian practitioners who advise clients on trust and estate matters. Accordingly, this submission focuses on the category of notifiable transactions that the Department has described as "Avoidance of Deemed Disposal of Trust Property" transactions. This submission delineates a number of issues and anomalies surrounding compliance with the proposed section. After canvassing them, it concludes with an alternative recommendation that will obviate the need for the Department to include deemed disposal of trust property within the ambit of section 237.4.

## A. Who needs to file the section 237.4 information return?

According to proposed subsection 237.4(4), an information return must be filed by every person described in that subsection, including the person receiving a tax benefit from a notifiable transaction, a person who entered into the notifiable transaction for the benefit of the person who received the tax benefit, or any advisors in respect of the notifiable transaction. A document released by the Department labelled "Backgrounder", identifies transactions where a trust transfers property or issues a promissory note to a corporation prior to the 21st anniversary of the trust as notifiable transactions. The Department further extends the definition by making reference to transactions that are the same or substantially similar to what the Department has identified as a notifiable transaction. This reporting obligation would also apply to any professional advisors to the trust involved in the creation, development, planning, organizing or implementing the transfer or issuance. However, it is unclear whether separate information return filing obligations under subsection 237.4(4) <u>also</u> extend to any of the following persons or entities:

### 1. The corporate beneficiary receiving the property or promissory note

The corporate beneficiary receiving value on the notifiable transaction is not receiving any tax benefits – because it is not enjoying reduction, avoidance or deferral of tax by receiving property or a promissory note. The corporate beneficiary is also not entering into a transaction for the benefit of the trust simply by virtue of being a recipient of a gift. However, it is unclear how the broad definition of "transaction" in subsection 245(1), which defines a transaction to include an arrangement or event, and which is explicitly imported for this purpose per subsection 237.4(1), affects this determination.

### 2. Beneficiaries of the trust

Beneficiaries of the trust are not receiving any tax benefit by virtue of the trust avoiding the deemed disposition rule. But when the trust makes a distribution to a specific corporate beneficiary, it is debatable whether all other beneficiaries have "entered into" the notifiable transaction for the benefit of the trust by virtue of the fact that the value of their respective beneficial interests in the trust may have decreased in value. The broad definition of "transaction" imported from subsection 245(1), and the fact that paragraph 251(1)(b) deems all beneficiaries not to deal at arm's length with the trust and, by extension, with the trustee of the trust due to subsection 104(1), potentially compounds this uncertainty. Also, does it matter whether the beneficiary is aware of, or has assented to, the notifiable transaction? What about scenarios where the trustees do not disclose information to the beneficiaries? What about scenarios where individuals are unaware they are even beneficiaries of a trust?

3. **Contractor(s) engaged by the trust (e.g. bookkeeper)**

To the extent contractors assisted with either the creation, development, planning, organization or implementation of the notifiable transaction, they may be construed to be advisors in respect of the transaction.

4. **Employee(s) of a different entity not dealing at arm's length with the trust**

Often, a family employs a person (e.g. bookkeeper) to manage various entities, including a family trust, and that person may be employed by an entity within the group of entities but not the trust or the trustee itself. Such a person may also be construed to be an advisor in respect of the transaction.

5. **Advisors**

As a corollary, it is also unclear whether advisors to all persons noted above to the extent they have assisted or advised on aspects of the notifiable transactions would have a corresponding reporting obligation.

**Recommendation**
Due to the substantial penalty involved with non-compliance with section 237.4 and the administrative burden required to produce the information in multiple information returns, we request that the Department clarify this issue, perhaps by publishing a number of case studies for illustration purposes.

## B. Estates being required to file 237.4 returns

Estates are considered trusts for purposes of the Act – see the definition of "trust" in subsection 248(1). Estates would rarely last more than 21 years and they are often wound up within 36 months. However, they could be caught under proposed section 237.4 due to the way the Department has defined notifiable transactions. For instance, an estate could:

(1) Distribute property to a corporation that has a trust as one of its shareholders (for example, as part of post-mortem estate planning unrelated to extension of the 21-year deemed disposition rule);

(2) Distribute property to a corporation that has a non-resident beneficiary amongst its shareholders (for example, where by will, a testator appointed a professional corporate trustee outside Canada to receive and administer estate assets on behalf of a foreign beneficiary of the estate);

(3) Receive an actual or deemed dividend from a corporation it owns and designate that dividend under 104(19) to a corporation that has a trust or non-resident amongst its shareholders (for example, where spouses die within a short period of time of each other and each have an estate with related corporations).

All of the above appears to fall within the Department's notifiable transaction designation since the Department did not specify when a designated transaction needs to be relative to the period of time before a trust's 21-year anniversary (i.e. a trust making a capital distribution within the first year of its settlement to a corporate beneficiary in which another trust is a shareholder is designated as a notifiable transaction, even though 21-year anniversary is 20 years away). The inclusion of estates into section 237.4 appears to be unintended because an estate does not often last beyond 21 years.

### C. Indefeasibly vested trusts and unit trusts being required to file 237.4 returns

According to paragraphs (f) and (g) of the definition of "trust" in subsection 108(1), for various purposes of the Act including the 21-year anniversary deemed disposition provision of subsection 104(4), a trust excludes:

(f) a unit trust, or

(g) a trust in which all interest has vested indefeasibly.

Because these trusts are not subject to the 21-year anniversary deemed disposition rule, the mischief targeted by the Department in its designation for section 237.4 (as it relates to the avoidance of the 21-year anniversary rule) does not apply to them. Therefore, we recommend that the Department exempt from its notifiable transaction designation a subsection 107(2) tax-deferred capital distribution or a subsection 104(19) designated income distribution carried out by a paragraph (f) or (g) trust to a corporate beneficiary, provided that corporate beneficiary has no non-residents as shareholders.

### D. Broadness of the "a series of transactions that includes the notifiable transaction" terminology

Proposed subsection 237.4(4) requires a return to be filed for a transaction that is "...a series of transactions that includes the notifiable transaction". Also, the proposed definition of notifiable transaction includes "...a transaction in a series of transactions that is the same as, or substantially similar to, a series of transactions that is designated at that time by the Department under subsection (3).".

What a "series of transactions" encompasses can be extremely broad due to its expanded definition in subsection 248(10) and due to the Court's wide interpretation of this term. A transaction can be part of a series even if it takes place many years apart from a notifiable transaction. Ultimately, whether a step is part of a series of transactions will be in the eye of the beholder, and in administering section 237.4, the CRA will have the benefit of hindsight in assessing whether a transaction before or after a notifiable transaction is part of a series of transactions that include the notifiable transaction. In fact, the proposed legislation encourages disclosure even where it is unclear whether a transaction is part of a series: proposed subsection 237.4(13) provides that a section 237.4 filing "is not an admission by the person that any transaction is part of a series of transactions".

Given the significant penalties that would befall someone who misses their reporting obligation under section 237.4, we believe such a degree of uncertainty whether a transaction is indeed part of a series and therefore would attract such penalties poses extremely difficult compliance challenges to taxpayers and their advisors, which are almost impossible to comply with in practice, due to the uncertainty created by statutory interpretation. Uncertainty aside, the broadness of the reference to a series also makes the reporting extremely burdensome. For example, it is possible that following a distribution by a trust to a corporate beneficiary, any future dividends by that corporation will be part of a series of transactions that includes that original distribution (because those future dividends are directly or indirectly funded by such distribution). If this is correct and the corporate beneficiary had a trust or a non-resident as shareholder, the corporation and all its advisors will have to make a section 237.4 filing within 45 days of all future dividends. We doubt this is intended and encourage reconsideration of the breadth of the proposals.

### E. Possible retroactive application due to "a series of transactions" terminology

According to the coming-into-force provision, proposed subsection 237.4 will apply “with respect to notifiable transactions entered into after 2021”. However, because a notifiable transaction includes a transaction in a series of transactions that is designated by the Department as notifiable transaction, it appears possible that planning transactions before 2021 could be caught. For example, suppose a trust, in 2020, made a distribution to a corporation in circumstances described by the Department in its designation, and then in 2022, there were subsequent transactions that may be considered to be part of the same series of transactions as the original distribution (e.g. a subsequent disposition of the distributed assets by the corporate beneficiary). Would those transactions be considered a notifiable transaction entered into after 2021 even though the purportedly targeted part of the transaction, i.e. the trust distribution, occurred in 2020? This would compel taxpayers to disclose transactions that occurred before the coming-into-force or announcement of section 237.4.

### F. *De Minimis* Threshold

As proposed, even a subsection 107(2) distribution of a property worth $1 or a subsection 104(19) designation of a $1 income distribution amount is potentially caught by section 237.4. It is important to note that subsection 107(2) applies automatically to a capital distribution by a personal trust, and a subsection 104(19) designation is done automatically by the trust tax return software. Most applications of these two provisions occur in everyday trust transactions where the 21-year anniversary isn’t being contemplated at all. In light of this, the penalty provision, which employs a “greater of” formula will most often be completely disproportionate to a transaction of nominal value, and also unnecessary because any tax benefit that may occur is also nominal and likely unintended by the taxpayer.

Therefore, we request the Department consider adding a *de minimis* exemption for a trust’s capital or income distribution of cash or property with less than $50,000 of fair market value.

### G. Clarification as to whether freeze transaction in favour of Holdco owned by new trust is contemplated by the Department

Proposed subsection 237.4(1) defines a notifiable transaction to include a transaction that is “substantially similar” to a transaction designated by the Department. Proposed subsection 237.4(2) then states that the term “substantially similar” needs to be “interpreted broadly in favour of disclosure”. Will this catch a freeze transaction where a trust exchanges common shares of a corporation (Opco) into fixed value preferred shares that are redeemable/retractable for an amount equal to the exchanged common shares, and simultaneously new common shares of Opco are issued at nominal value to another corporation (Holdco) in which a different trust or a non-resident person is a shareholder? We do not believe that should be the case since the transaction does not involve subsection 107(2). The value in the transferor trust’s hands also remains the same before and immediately after the transaction, even though future growth of Opco will accrue to the hands of Holdco. It will be helpful if the Department explicitly clarify that dispositions by a trust in situations such as this (or any disposition that does not involve application of subsection 107(2)) are not "substantially similar" to the transactions designated for section 237.4.

## H. Trustee's information gap about ownership of corporate beneficiaries

Many family trusts are drafted with a broad class of corporate beneficiaries. For example, beneficiaries may include "all corporations in which a named individual beneficiary is a shareholder", and the named individual beneficiaries are often drafted broadly as well to include relatives outside the core family members. Because of this, a trustee of a trust may not have the necessary visibility to confirm whether a different trust or a non-resident is amongst the shareholders of a corporation receiving a distribution from the trust. This is particularly likely if such shareholding is in a higher tier of the corporate ownership structure. (We presume the Department's designation would extend to distributions to holding companies in which a trust or non-resident has indirect ownership).

We would request that the Department clarify whether evidence of a trustee asking a corporate beneficiary to confirm that neither a trust nor a non-resident is a direct or indirect shareholder would be sufficient to satisfy the due diligence defence in proposed subsection 237.4(12).

## I. 45 days for filing the Information Return is insufficient time

Proposed subsection 237.4(5) requires the filing of the information return within 45 days of the earliest of the events of subparagraphs (a)(i) to (a)(iii). Usually, trustees of a trust cannot properly determine the nature of the distributions the trust made during a fiscal year until they receive a full financial picture of the fiscal year of the trust, and a large part of that involves compiling and recording the various T-income slips received by the trust for the year. T5 slips are not due until the end of February, and thus calendar year trusts have until March 31 to file T3 trust returns. Therefore, we submit that the reporting requirement that a notifiable transaction needs to be disclosed within 45-days of the transaction is not realistic for trusts.

## Recommendation

Proposed section 237.4 is a burdensome and a heavily punitive provision. It creates many administrative and interpretative issues such as those pointed out above. Rather than including these trust dispositions into the ambit of proposed section 237.4, we believe there is a simpler solution that will achieve the same disclosure objectives. The 2022 T3 Trust Income Tax and Information Return can be augmented with an additional item to the questionnaire section of the return:

"*If the trust is not an estate and is not a trust described in paragraphs (f) and (g) of the definition of a "trust", did the trust either (i) transfer property with fair market value exceeding $50,000 pursuant to subsection 107(2) to a corporation in which another trust or a non-resident person directly or indirectly has an interest, or (ii) distributed an amount over $50,000 for which the trust makes a dividend designation under subsection 104(19) to a corporation in which another trust or a non- resident person directly or indirectly has an interest?*

*If so, attach a schedule giving a complete description of the property distributed, the name and business number of the corporate beneficiary, and a description of each transaction of the series of transactions that included the transfer or distribution."*

This question will provide all of the information that the Department is seeking from the notifiable transaction designation. The trustees must accurately and fully answer the question as it would otherwise be subject to the false statements or omissions penalty in subsection 163(2). Moreover, this tax return disclosure requirement will allow the Department to obtain the same information with respect to these trust transactions as it would by including them in section 237.4.