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Tax Alert – Canada

Updated CRA guidance on penalty relief for late bare trust T3 filings

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 12 March 2024, updated administrative guidance was released by the Canada Revenue Agency (CRA) on how it intends to apply an “education-first” approach to the application of significant late-filing penalties in respect of bare trusts.

Legislative amendments enacted in December 2022 require many trusts, including bare trusts and other informal trust relationships, to file an annual T3 trust income tax and information return (T3 return).

Since all trusts affected by the new requirements have a calendar year-end, the new rules effectively apply for the 2023 and later taxation years. A trust with a calendar year-end must file its income tax return for the 2023 taxation year by 2 April 2024,¹ and this return has to include new information required under these rules.²

¹ Since 30 March 2024 occurs on a Saturday, the filing deadline is administratively deferred to the next business day, 2 April 2024.

² For more information on the history of the new requirements, see [EY Tax Alert 2022 Issue No. 4, Proposed trust additional reporting requirements](#), [EY Tax Alert 2022 Issue No. 37, Finance releases draft legislation for remaining 2022 budget measures](#) and [EY Tax Alert 2022 Issue No. 45, Bill C-32 to implement certain Budget 2022 and other previously announced measures receives Royal Assent](#). For information on the application of the new rules, see [EY Tax Alert 2023 Issue No. 41, New trust reporting requirements apply for the first time to the 2023 taxation year](#), [EY Tax Alert 2024 Issue No. 2, New Canadian trust reporting requirements to impact many foreign trusts](#) and [EY Tax Alert 2024 Issue No. 4, New trust reporting requirements are broader than you think](#).

Penalty framework

Under the *Income Tax Act* (the Act), a new penalty framework for trusts was introduced under subsections 163(5) and (6) and applies to any person or partnership that is subject to the additional reporting requirements in new section 204.2 of the *Income Tax Regulations* and that fails to file a T3 return (including the Schedule 15 beneficial ownership schedule) for the taxation year, effective for taxation years ending after 30 December 2023. These penalties are equal to the greater of \$2,500 and 5% of the highest total fair market value of all property held by the trust in the year, with no maximum penalty.

Of specific concern to taxpayers has been the language contained in subsection 163(5), which could apply the harsh penalty framework under circumstances where the taxpayer “knowingly or under circumstances amounting to gross negligence” failed to file a return.

As the new T3 return filing obligations have been extended to include an entire population of arrangements that previously did not apply, many taxpayers are *aware and know* of their obligation to file the tax returns but are struggling to meet the compliance requirements due to the volume of expanded tax returns and/or the inability to obtain information about known persons who are to be disclosed on the new Schedule 15. Additionally, other taxpayers are still in the process of determining if certain arrangements constitute a bare trust (subject to the T3 return filing requirement) and may, therefore, need additional time to consult with their legal counsel to reach a conclusion.

Administrative relief

On 12 March 2024, the CRA updated sections of its web page, “[New reporting requirements for trusts: T3 returns filed for tax years ending after December 30, 2023,](#)” which provides administrative guidance associated with the new trust filing obligations.

Specifically, Section 3.5 of the CRA’s guidance was updated to address the intended application of the expanded penalty framework associated with subsections 163(5) and (6) of the Act.

The text of the CRA’s update is reproduced below:

As some bare trusts may be uncertain about the new requirements, the CRA is adopting an education-first approach to compliance and providing relief to bare trusts by waiving the penalty payable under subsection 162(7) of the Income Tax Act for the 2023 tax year in situations where the T3 Return and Schedule 15 are filed after the filing deadline for reasons other than gross negligence. For the 2023 tax year, where the tax year of the trust ends on December 31, 2023, the filing deadline of March 30, 2024, is extended to April 2, 2024, the first business day after the deadline.

This proactive relief is for bare trusts only and only for the 2023 tax year.

While the Act also includes a gross negligence penalty under subsection 163(5), as part of the CRA's education-first approach, the CRA will only apply this penalty in the most egregious cases where a bare trust fails to file. Imposing such penalty would only occur in the context of a compliance action, such as an audit, where all factors and circumstances of the taxpayer's particular situation are considered together. A gross negligence penalty for failing to file will be subject to oversight and approval by Headquarters, following a mandatory referral.

Under the Act, the gross negligence penalty is equal to the greater of \$2,500 and 5% of the highest amount at any time in the year of the fair market value of all the property held by the trust.

Implications of updated guidance

The updated administrative guidance represents welcome relief to taxpayers. However, two key insights and issues remain:

1. Trusts remain statutorily obligated to file a tax return by the deadline, albeit potentially not subject to penalties if filing late under circumstances that do not amount to gross negligence. The updated guidance does not represent a formal filing extension and does not parallel administrative relief provided for the first year of Underused Housing Tax filings (extensions were granted in advance of the Underused Housing Tax filing deadline).
2. Taxpayers should assess their individual situations and consult with their legal or tax advisors to understand the extent of the implications associated with a failure to file the bare trust tax return by the filing deadline. An assessment of the overall tax compliance history may identify instances of non-compliance in other areas, such as unreported income or the failure to file information returns in an agent's/nominee's capacity.

For greater certainty, agents and nominees have always had an obligation to file a T3 return, T5 information return or T5013 information return under the *Income Tax Regulations* for various forms of income generated on investments held in trust for an ultimate beneficial owner.³ Identification of various bare trust and nominee arrangements with a view to complying with the new expanded Schedule 15 disclosure requirements may uncover instances of non-compliance with various historically required information returns. Voluntary Disclosure Program applications may be a relevant consideration to address penalty exposure.

³ Subsections 204(1), 201(2) and 229(2) of the *Income Tax Regulations* require an agent to file a T3, T5 and T5013 information return, respectively, under an agency or nominee relationship.

Learn more

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