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INTERNAL TRUSTS OF CHARITIES: POSSIBLE T3 REPORTING MAY BE LESS APPLICABLE IN QUÉBEC

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Beginning with taxation years ending after December 30, 2023 (i.e., beginning for the most part with the March 2024 trust tax filing season), generally all express trusts² will have an obligation to file a T3 tax return, including the new Schedule to the return that sets out the trust's trustees, beneficiaries, settlors, and other influential persons such as protectors. Surprisingly, the CRA is apparently indicating that internal trusts³ of registered charities will be subject to this filing obligation, which would be onerous when one considers the number of potential internal trusts of this kind and resulting costs of compliance, and given that charities would not have expected this obligation and are already reporting on such trusts as part of their financial statements and therefore within the data of the T3010 annual charity information return.

This article will briefly review the CRA's apparent position on internal trusts,⁴ and will also underline that such trusts are likely less prevalent in the Province of Québec, therefore likely substantially reducing, at least in Québec, the filing obligation. In the view of many, the CRA's apparent position should be withdrawn, and this potential imbalance as between provincial jurisdictions in the application of the position is one more reason to do so.

Internal Trusts Pre-2023

Prior to 2023:

- Registered charities, including those formed as trusts, have been filing a T3010 annual information return setting out a charity's financial situation and implementation of its charitable purposes.⁵ This obligation continues, of course, for 2023 and following years;

¹ The author acknowledges the contribution of Emma Murrin, articling student at Spiegel Sohmer Attorneys, who provided research assistance for this article. Any errors or omissions remain those of the author.

² Known under Québec civil law as a trust other than a trust established by law or by judgment.

³ It has been observed that in this context, internal trusts mean restricted funds held by charities as an express internal trust that is not available for the general purposes of the organization. In the common law, the intention of the donor and charity may turn the restriction into a "special purpose charitable trust", also called a "donor restricted trust fund", a "charitable trust property", a "special purpose fund", an "endowment fund", or a "restricted fund". For example, these restrictions could be about the length of time the capital is to be held, or the purposes for which the funds are to be used. Tangible examples, among many others, could be certain scholarship funds or building funds. See more on this topic at Terrance Carter, Theresa Man, Jacqueline Demczur and Lynne Westerhof, "Changes to Trust Reporting Rules Will Seriously Affect Charities, Clarity Needed", *Charity & NFP Law Bulletin* No. 522 (June 29, 2023), at pp. 5–9 ("Carter").

⁴ We have seen restricted gifts often booked as deferred revenue on the charity's financial statements.

⁵ Subsection 149.1(14) of the *Income Tax Act* (Canada) (the "ITA").

- Until 2023, the CRA's *T3 Guide* (T4013) set out an administrative position that the CRA would not require a T3 return from a trust with, for example, no income, or from one that does not make distributions. It was never suggested that a registered charity that was itself a trust had to file a T3, and this appears to be implied by the position formerly contained in the *T3 Guide*;
- As for internal trusts of charities (as opposed to the charity itself), few would have thought they would have been required to file a T3. Indeed, the CRA had indicated that a restricted fund held by a charity, reported upon within the financial statements and on the T3010 of the charity, would not have to itself be registered as a charity and by analogy would not have to file a separate T3.⁶

Internal Trusts Post-2022

Post-2022:

- Registered charities including those formed as trusts continue to file a T3010 annual information return;
- The abovementioned CRA administrative position in the *T3 Guide* has been withdrawn. Instead, the ITA has been amended to generally require all trusts to file (for tax years ending after December 30, 2023) a T3 trust return, other than certain entities stated as being exempt which include "a registered charity".⁷ Non-compliance is subject to a first penalty of \$25 per day with a minimum of \$100 and up to a maximum of \$2,500, with there also being a gross negligence penalty equal to the greater of \$2,500 or 5% of the value of the property of the trust;⁸
- Do these new post-2022 rules really oblige the internal trusts to be reported on their own T3? One might not have thought so as that would be radically different from the past and it is not immediately obvious from these new rules. However, some have observed that these new rules do not specifically exempt the internal trusts, as they are silent on the point;
- An article by Tim Cestnick in the *Globe and Mail* has pointed out that Finance and the CRA are indicating that the intent of the new rules is to include internal express trusts held by charities as being required to file a T3.⁹

Internal Trusts in Québec

For charitable gifts governed by Québec law, (i.e., relating to most of the internal express trusts held by charities in Québec, and perhaps some of the internal express trusts held elsewhere), the charities will turn to Québec civil law to determine whether an internal trust exists and will potentially find arguments to support the view that no such trust exists, therefore putting aside the need to file a T3 return for that gift, even if the CRA continues with the policy that internal trusts must file one. The reasons mitigating against an internal trust under Québec law would include:

- Under the common law, the CRA has taken 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)."¹⁰ That intention element presumably applies also to the common law purpose trust that relates to the charitable context;

⁶ See Carter at pp. 5–6, referring to the CRA's former policy on "restricted funds" (Summary Policy CSP-R22), and the current definition of "restricted funds" found in the CRA "Charities and giving glossary" at www.canada.ca (date modified: December 3, 2018).

⁷ See principally new subsections 150(1.2)–(1.4) of the ITA, amended subsection 104(1) of the ITA, and new Regulation 204.2 of the *Income Tax Regulations* under the ITA.

⁸ Subsections 163(5) and (6) of the ITA.

⁹ Tim Cestnick, "New Canadian Tax Changes Create an Unmanageable Burden for Charities", *The Globe and Mail* (July 6, 2023), at www.theglobeandmail.com. See also Carter at pp. 6–7.

¹⁰ CRA Document, 9832537, "Disposition-probate and income tax issues" (March 11, 1999).

- In contrast, although Québec law also looks at intention to see if a trust is created, a Québec trust has very different theoretical and practical underpinnings as compared to a common-law trust. For instance, there is no division between legal and beneficial ownership in Québec. A unilateral declaration of trust is not possible under Québec law; rather, in a Québec trust the settlor transfers property from its patrimony (i.e., roughly, from its personal balance sheet) to another separate patrimony appropriated to a particular purpose, which a trustee undertakes by its acceptance to hold and administer. Neither the settlor, the trustee, nor the beneficiary have a real right (akin to a right *in rem*) in the trust patrimony (the trust property).¹¹ This applies equally to Québec's version of the purpose trust, known as a social trust.¹² Québec courts appear to examine with care whether the separate patrimony required for a trust exists, and have sometimes held other arrangements to exist instead, such as a gift subject to restrictions.¹³
- Furthermore, note that, unlike in the common law, a civil law gift is formed by contract between the donor and the donee, with the transfer of property being by gratuitous title.¹⁴ One practical result of this is that although the constitution of a trust in Québec in essence may be made through a gift, the concept of the gift as a contract — similarly to the above-mentioned concept of the trust as a separate patrimony by appropriation — appears to require an explicit intent to form a trust that may not be easily found.¹⁵ Additionally, many charities would not qualify to be a trustee under a Québec trust, as the CCQ requires a trustee to be either a physical person, or a corporation authorized by law to act as a trustee;¹⁶
- As a result, the better argument will often be that a restricted gift in Québec creates a gift subject to restrictions that is not, however, a trust, i.e., subsequent to the transfer of the gift to the charity, a debtor-creditor relationship concerning the restriction may exist among the charity and the donor, but there is no establishment of a trust.¹⁷ If an internal special purpose charitable trust is to exist in Québec, the donor and the charity would be best off setting up the trust by actual deed of trust, rather than relying upon the entering into of a gift without trust language to create a trust.¹⁸

Note that as would be the case in any Canadian jurisdiction, a charity in Québec entering into an internal special purpose charitable trust, and in fact into any gift with restrictions, must take care to stipulate sufficient discretion on the part of the charity with respect to the actual carrying out of the terms of the gift. Otherwise, there can be a risk that the donor may be seen as retaining enough rights such that a gift will not be seen as having been made, putting at risk the valid issuance by the charity of a donation tax receipt, or putting in question whether the charity has

¹¹ See for example *Groupe Sutton-Royal Inc. (Syndic de)*, 2015 QCCA 1069 ("Sutton") at paragraphs 96 and following (bankrupt real estate agency held to not hold commission monies in trust for its real estate brokers). See also *Bank of Nova Scotia v. Thibault*, 2004 DTC 6437 (SCC) (financial institution held to not hold self-directed RRSP funds in trust for the investor). See also articles 1260, 1261, 1265, and 1275 of the *Civil Code of Québec* ("CCQ").

¹² Article 1270 CCQ.

¹³ See *Raymond Chabot Inc. v. Fondation Communautaire de Lachine*, 2013 QCCA 890 (funds gifted to a hospital foundation to be used for stated purposes seen as a full transfer of property to the foundation, and not as a transfer to the foundation to simply manage the property as a trustee, therefore the gift did not create a trust).

¹⁴ Article 1806 CCQ.

¹⁵ See Joseph Sirois, of Department of Justice Canada, "*The Concept of a Gift/Don, Comparative Study — Civil Law — Common Law — Tax Law*", at www.justice.gc.ca, in particular reference to the trust set up by gratuitous title under Québec civil law, at paragraph 1.6, reference to the contract of gift under Québec civil law being a nominate contract distinct from the trust, at paragraph 4.1, and reference to the gift in trust made through an express trust under the common law, at paragraph 2.5.

¹⁶ Article 1274 CCQ. Qualified trust companies are the main corporations that may be a trustee, and notably possibly also non-share capital corporations incorporated under the *Canada Not-for-profit Corporations Act* ("CNCA"), per sections 31–32 CNCA.

¹⁷ See for example *Sutton*, at paragraph 121, where Kasirer, J.A., as he then was, found that although no trust was created, an ordinary debtor-creditor relationship was created with a personal right of claim.

¹⁸ See Troy McEachren and Christos Panagopoulos, "The Canada Not-For-Profit Corporations Act and Quebec Trust Law: A New Opportunity for Quebec Donors", (2015) 93 *The Canadian Bar Review* 193, where there is discussion of the establishment through a deed of trust under Québec law of a charity's internal social trust (akin to a purpose trust).

sufficient control over its activities.¹⁹ The charity would also not want to be seen as being a mere conduit allowing, for example, for the transfer of property from the donor to a non-qualified donee through the intervening accommodation of the charity.²⁰

A further example essentially indicating that charities cannot allow themselves to be a conduit for their donor is in a recent Canadian Tax Foundation CRA Roundtable answer. This concerned a scenario in which a charity transfers property to a named grantee organization (as a “qualifying disbursement” as defined at subsection 149.1(1) of the ITA) in accordance with a donor’s letter of wishes expressing hope that the charity would make the transfer, and the CRA indicated that it would be a question of fact and law to be determined on a case-by-case basis as to whether honouring the letter of wishes violates the anti-directed giving rule at paragraph 168(1)(f) of the ITA.²¹

Internal Trusts: Clarity Needed From the Government

Ideally, the CRA and/or Finance would confirm, well prior to the March 2024 trust tax filing season, that charities’ internal special purpose charitable trusts are not required to be reported on a separate T3 trust tax return, but rather may continue, post-2022, to be reported only in the financial statements of the charity and on the charity’s T3010 charity information return. In the absence of such confirmation, charities in Québec (and sometimes elsewhere) will be obliged, among other things, to review on a case-by-case basis whether their restricted gifts are governed by Québec law (which will often be the case for Québec charities), and whether those restricted gifts constitute a Québec trust, which will often not be the case.

AUGUST 4 DRAFT LEGISLATION

As announced in Tax Topics 2683 last week, the Department of Finance published new draft legislation on Friday August 4. The legislation proposes to enact several measures announced in Federal Budget 2023, the Global Minimum Tax (Pillar Two), the Digital Services Tax, certain sales and excise tax measures, and various technical amendments. The following are some additional details of measures contained in the legislation:

Measures To Grow Canada’s Clean Economy

- Amendments expanding the Carbon Capture, Utilization and Storage (“CCUS”) Investment Tax Credit;
- Introduction of a new 30% refundable Clean Technology Investment Tax Credit for property that becomes available for use after March 28, 2023. The credit will be phased out starting in 2033 and become fully phased out in 2035;
- Labour requirements, including prevailing wage and apprenticeship conditions, that must be met to obtain maximum credit for the CCUS and the new Clean Technology Investment Tax Credit;
- Extending the temporary corporate income tax rate reductions for zero-emission technology manufacturers by three years to 2034; and

¹⁹ For example, in the context of a donor advised fund (a “DAF”), the charity operating the DAFs should advise donors that their input in relation to the DAF can be of an advisory nature only. (See in this regard Jacqueline Demczur, “Primer on Donor Advised Funds and Current Issues — Revisited”, CBA Charity Law Symposium (May 12, 2023) at p. 14.)

²⁰ For example, when discussing the new anti-directed giving rule at paragraph 168(1)(f) of the ITA indicating that a charity should not accept a gift that is expressly or implicitly conditional on the charity granting it over to a specific non-qualified donee, the CRA has recently indicated that charities should act independently and not act as a conduit; for example, a charity should not solely fundraise for a non-charity affiliate. See Canada Revenue Agency, “Registered Charities Making Grants to Non-Qualified Donees (Draft)”, CG-032 (November 30, 2022) (the “Draft Qualifying Disbursement Guidance”), at www.canada.ca, at paragraphs 72–76. The CRA is expected shortly to update the Draft Qualifying Disbursement Guidance.

²¹ 29 November 2022 CTF Roundtable Q. 14, 2022-0950551C6 — Charities — Transfer of Property to a Grantee Organization.

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