

TAX ALERT



TAX ALERT is a commentary on topics of current interest – usually topics relating to recent changes in tax law, new CRA administrative practices or current interpretations arising from tax cases. Professional advice should be obtained before acting on any of this information. *ed.1/07*

ADMINISTRATIVE OBLIGATIONS OF TRUSTEES

This Newsletter discusses certain income tax matters relevant to the administration of personal trusts.

Allocating Trust Income to Beneficiaries

A trust is a flow-through entity that allows trust income to be distributed to beneficiaries and taxed to them rather than the trust. Trustees must ensure that such income is paid or payable to the beneficiaries by the trust's year-end in order to have the income taxed in the hands of the beneficiaries. Income not paid or payable by the year-end will be taxed in the trust (at the highest marginal tax rate for inter vivos trusts). An amount is only payable to a beneficiary in the year if the beneficiary is entitled to enforce payment in the year (Interpretation Bulletin – IT-286R2)

Payments to beneficiaries can be made directly or by paying expenses on behalf of beneficiaries (such as education, child care, recreational activities, camps, etc.). Payments made to beneficiaries are sometimes loaned back to the trust to restore trust capital to its original amount.

Trust Income Payable

There are many situations where trust income is not paid to or on behalf of the beneficiaries prior to the trust's year-end. As long as the amount payable is supported by a written resolution of trustees to pay out trust income (as defined in the wording in the trust agreement) once the amount is known, then the income should be taxed to the beneficiary and not the trust.

The resolution should quantify either the amount or percentage of trust income payable – even if it is not known prior to the trust year-end. The resolution should be passed before the year-end and should specify how the income will be divided among the beneficiaries. Once the amount is quantified, the income should be paid out or a demand promissory note issued to beneficiaries. The promissory note should be delivered to each beneficiary or legal guardian of the beneficiary to be enforceable and meet CRA's requirements (Interpretation Bulletin – IT-342R)

Payments for Children

Parents are legally obligated to provide children with the necessities of life. Where trust funds are used for this purpose, parents have realized a benefit because they are using the children's funds, rather than their own, to provide these necessities. As an administrative matter, CRA will not assess a benefit to the parents.

A CRA technical opinion indicated that payments made by a trust to third parties or as reimbursements to the parents will be considered payable to the beneficiaries as long as “it is reasonable to consider that the payment was made in respect of an expenditure for the child’s benefit; i.e. amounts paid for the support, maintenance, care, education, enjoyment and advancement of the child, including the child’s necessities of life” (Technical News No. 11). CRA has therefore sanctioned the payment by trusts for expenditures normally incurred by parents. It is important to substantiate expenses paid on the beneficiaries’ behalf to stay onside with CRA’s position in case you are audited.

If the trust is non-discretionary and the only reason income was not paid to the beneficiary by year-end was because the age of the beneficiary, the income is considered payable to the beneficiary and can be taxed in the beneficiary’s hands if the following conditions are met (Interpretation Bulletin – IT-342R):

- ◆ The right to the income vests with the beneficiary by the year-end and
- ◆ The beneficiary is a minor

If the non-discretionary trust does not comply with the above conditions, trustees should consider taking steps described earlier to cause the income to be paid or payable.

Trustee Resolutions

To summarize, if all of the trust income has not been distributed to beneficiaries during the trust’s year, trustees should either make additional payments by the trust’s year-end or prepare a resolution prior to the trusts year-end in respect of the undistributed income to assure that the amounts are in fact payable. It is recommended that these resolutions and related promissory notes are issued by the trustees (preferably prepared by legal counsel to the trust) to ensure that the trust income is considered “paid or payable”. The resolutions can be worded to continue from year to year or can be prepared annually.

Relevant CRA Publications

The following CRA publications contain more detailed information on CRA’s various positions summarized above as well as some related issues.

Payments Made by a Trust for the Benefit of a Minor Beneficiary	Technical News No. 11
Taxable Benefit for Use of Personal Use Property	Technical News No. 11
Trusts – Amounts Payable	IT-286R2
Trusts – Income Payable to Beneficiaries	IT-342R

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