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CESTNICK

TAX MATTERS

Uncertainty and complexity are the hallmarks our tax system today

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Most of us have come across those head-scratching questions when doing our taxes. Do I need to declare this? Can I deduct that? The good folks at the Department of Finance seem to have a knack for making things unbelievably complex. Recent tax changes just underline that point.

The changes

Last week I wrote about changes that could affect your tax filing this year, and one change in particular struck a nerve with many folks. I'm talking about the new trust reporting rules, which require all trusts to file tax and information returns annually and to disclose important information about beneficiaries. Yet, under the changes, a number of other arrangements may be caught by the new rules.

Here's the problem: There's still uncertainty about specifically when the new rules might apply. Do you have a trust, or not? You may have financial arrangements that are deemed to be a trust without even realizing. To make matters worse, if you fail to file the appropriate information with the taxman you could face a penalty up to $2,500 – and if you're considered to have done this "knowingly or under circumstances amounting to gross negligence," the penalty can be 5 per cent of the highest fair market value of the property held by the trust for the year.

As an example of the confusion, the new rules will apply to so-called "bare trusts," which are arrangements where a person, or trustee, acts as an agent for certain beneficiaries with respect to all dealings in the property held in trust. In such cases, the trustee has no obligation other than to deal with the trust property as instructed by the beneficiaries. A bare trust could include arrangements such as (1) adding an adult child or someone else on a property's title to simplify your estate planning, or (2) an adult child purchasing a home and adding a parent on title to help with qualifying for a mortgage.

Other informal trust or agency relationships might also require tax and information filings now. I think of situations where a parent or grandparent opens an in-trust-for (ITF) account for the benefit of a minor child. Is this a valid trust arrangement that requires tax filings under the new rules? Accounts with $50,000 or less are exempt from reporting, but otherwise it's not clear.

Whether an ITF is a valid trust, or a bare trust, depends on the facts of each situation. The Canada Revenue Agency is likely to look at things such as how the account was established, and how it's been administered (including how income has previously been reported).

We could talk all day about the criteria for determining whether a valid trust exists, which are called the three certainties: (1) certainty of intention (there must be an intention to create a trust), (2) certainty of subject matter (clearly identifiable trust property that has been transferred to the trustee), and (3) certainty of objects (clearly identifiable beneficiaries of the trust). But I'm not sure this is going to help you decide whether to file a T3 Trust Income Tax and Information Return for ITF accounts or other arrangements you might have entered into. (The deadline to file the T3 is 90 days after the trust's year-end, which is Apr. 2 this year, since March 30 falls on a Saturday.)

Here's what's likely to happen: Most people will file a T3 return if they're not sure whether they're required to file, because they're concerned about the potential penalties if they fail to file and are wrong.

The bigger problem

The real issue here is that over the past decade our government has been fixated on revamping so many areas of our tax law that it has become unbearably complex. Most accountants have trouble understanding the various rules that have been introduced.

Another example is the new mandatory disclosure rules which can penalize tax preparers if certain types of transactions are not reported to the CRA. It's often not clear what kinds of transactions need to be. But you can bet that tax advisers are going to recommend reporting transactions for fear of facing big penalties if they fail to report and were wrong.

What we need is a tax system that is fair and simpler. We need to establish a royal commission on taxation to examine fundamental changes to our tax system – something that hasn't been done for more than 60 years when the Carter Commission recommended changes in the 1960s.

The current system isn't working. When tax changes are unclear and complex, and penalties are threatened for not filing properly, taxpayers will tend to file and disclose more information for fear of the penalties if they don't.

Scaring taxpayers and their advisers into unnecessary disclosure and making life a nightmare from an administrative perspective are not hallmarks of a well-designed tax system.

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