

TAB 3

Trust Administration – Best Practices

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TRUST ADMINISTRATION - BEST PRACTICES*

Cindy Radu and Siân Matthews**

INTRODUCTION

The objective of this paper is to explore “best practices” in trust administration to assist practitioners who act as trustee or advise clients who take on this fiduciary role. The paper focuses on practical recommendations in the context of *inter vivos* domestic trust structures. It is not intended to be all inclusive, but reviews common areas of weakness in light of Canada Revenue Agency (CRA) audit activity with respect to such structures. While some of the recommendations presented are not legal requirements, the fact that the CRA has expressed interest in seeing certain forms of documentation suggests that it is prudent to implement some basic practices that are often overlooked or disregarded by trustees.

The paper is set out in three parts.

- CRA Audit Activity – CRA audit initiatives and the questions the CRA is sending to settlors, trustees and their advisors.
- Common Issues in Trust Settlement and Administration – common weaknesses in trust set-up and administration and suggested best practices as well as possible solutions where these best practices have not been previously implemented.
- Considerations in Choice of Trustee – questions to explore with potential trustees.

CRA AUDIT ACTIVITY

Increased scrutiny of trust structures by the CRA has been a cause for reflection among advisors and trustees regarding trust administration practices. Issues that arise in trust law and trust administration are some of the most challenging that advisors and their clients face. When these issues are layered with the myriad income tax considerations, the role of trustee - even in the most basic family trust - is far from straightforward.

It has been just over a year since the Tax Court of Canada released its decisions in *Garron*¹ and *Antle*.² While these cases arose in the context of offshore trusts, the

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¹ *Garron Family Trust v. Canada*, 2009 TCC 450; heard by the Federal Court of Appeal on September 29, 2010.

implications of these cases for trusts established and administered in Canada have been emphasized by two significant CRA audit projects:

1. “Alberta” trusts – where the settlor and one or more of the beneficiaries reside in a province other than Alberta but where the sole trustee or a majority of trustees reside in Alberta.³
2. What are referred to herein as “domestic trusts” – trusts where the settlor, trustee and all or some of the beneficiaries reside in one province.

The domestic trust audit project that came to light in fall 2009 focused on Mississauga, Hamilton, Kitchener, London and Windsor. There were early indications that British Columbia was also a target area. As of the time of writing we have been able to confirm limited audits to date in Ontario and B.C., but the consensus seems to be a sense that significant audit activity is now underway. Whether audits are just starting to bubble to the surface remains to be seen. In the meanwhile, trusts should be reviewed to ensure that sufficient, relevant and appropriate documentation is in place to be able to respond in a timely fashion to any CRA audit enquiries (30 days from date of CRA letter).

Settlors, trustees and advisors have received questionnaires – often simultaneously – which can give rise to matters of consistency. Further, it is incumbent on advisors to ensure that the response deadline is met. Lay trustees in particular should be made aware that it is critical to review correspondence from the CRA in a timely manner. While some trustees will prefer to respond directly to the CRA themselves, many trustees will contact an advisor for assistance. We understand that the CRA has also started requesting interviews with the trustees.

Where the amount of information that needs to be compiled is extensive, it may be prudent to contact the designated CRA auditor to request an extension of time. Extensions may require the trustee to file a T2020 waiver in respect of the normal reassessment period. The implications of filing a waiver require consideration. Subject to matters of solicitor-client privilege, we recommend cooperation in providing the information requested. If, after providing the information requested, it becomes apparent that the auditor is intent on pursuing the matters under review, the best course of action

² *Antle et al v. The Queen*, 2009 TCC 465; heard by the Federal Court of Appeal on October 19, 2010 (written reasons released October 21, 2010, file no. A-428-09). The FCA dismissed the appeal based on the trust not being validly constituted as determined by the Tax Court. However, the FCA went on to disagree with Tax Court judge’s obiter comments that the trust was not a sham (“Certainty of Intention”).

³ This paper does not thoroughly examine issues surrounding residence of a trust given the pending FCA decision in *Garron* (“The Passive Trustee”). There have been numerous publications reviewing the Tax Court decision in *Garron* with respect to the matter of determining residence of a trust. See F. Ahmed, “Tax Residency of a Trust: The Need for a New Test? New Developments in the Residency of a Trust”, (2010) vol. 29, no.3 *Estates, Trusts and Pensions Journal* 219.

may be to request that the Notice of Re-assessment be issued, and file the Notice of Objection within the 90 day filing deadline and deal with appeals.

The scope of the questions in Appendix A⁴ offer insights as to best practices in trust administration to assist in withstanding audit scrutiny. Questionnaires emphasize the CRA's concerns with regard to the following common issues in trust settlement and administration.⁵

- Trust validity - inability to locate original settlement property, absence of accounting records and absence of documentation related to establishment of the trust ("Meeting the Three Certainties").
- Promissory notes issued to beneficiaries that may be unenforceable ("Allocations to Beneficiaries").
- Trustees (often the parents) taking cash out of the trust for their own use resulting in a deduction by the trust being challenged or a taxable benefit assessed to the trustee ("Payments to Minors").
- Prescribed rate loans to a trust where interest has not been paid by the trust within 30 days after calendar year end giving rise to possible attribution of income or capital gains ("Miscellaneous Best Practices").
- Consequences arising from 21-year deemed fair market value dispositions of capital property ("Miscellaneous Best Practices").

COMMON ISSUES IN TRUST SETTLEMENT AND ADMINISTRATION

TRUST SETTLEMENT

"Non-compliance" with conditions for valid trust settlement (the certainties of intention, subject matter and objects⁶) has proven to be an easy audit target for the CRA.

⁴ Questionnaires issued by the CRA Aggressive Tax Planning section have been gathered from a variety of sources. It is noteworthy that questionnaires sent out by the CRA in early 2009 (before *Garron* and *Antle*) asked 11 relatively simple questions (Appendix B; see Jack Bernstein, "Trust Residence Questioned" (2009) vol. 17, no. 7 *Canadian Tax Highlights* 1); more recent questionnaires are far more detailed and sophisticated.

⁵ At the 2010 STEP National Conference the CRA confirmed that the scope of audit activity is now Canada wide and has expanded to include issues not addressed in this paper including: deductibility of investment counsel and trustee fees, "kiddie tax", capital gains exemption multiplication and non-compliance with attribution rules. The CRA also confirmed that it is applying *Garron* to domestic trusts.

⁶ Certainty of objects is not addressed herein; it is primarily a trust drafting consideration rather than one of trust administration.

Certainty of Intention

Discussion

There are no technical requirements to establish intention to create a trust; intention is discerned with regard to the settlor's actions and words.⁷ In many situations, it is believed that the signature of a putative settlor on a trust document is sufficient to establish this intention. However, the signature is just one evidentiary factor to be considered. Too often a settlor is not informed of the contents of the trust document, making it challenging to assert her "intention to create a trust that she has not read and cannot explain".⁸ The reasons for asking an individual to act as settlor of a trust instrument of which they have no knowledge are varied; a misapprehension of the legal requirement for certainty of intention, a desire to have an aged grandparent settle the trust to potentially avail beneficiaries of the preferred beneficiary election or a strong desire for privacy of the trust terms.

The Tax Court in *Antle* addressed the intention of Mr. Antle in purportedly settling a trust for the benefit of his wife. After reviewing the series of documents and steps taken Miller J. concluded that Mr. Antle wanted to establish a trust to avoid capital gains tax in Canada. However, his intention to avoid tax by creating a trust did not equate with the necessary certainty of intention to settle this particular trust.

I reach the inevitable conclusion that Mr. Antle did not truly intend to settle shares in trust with [the trustee]. He simply signed documents on the advice of his professional advisors with the expectation the result would avoid tax in Canada.... Frankly, I have not been convinced Mr. Antle even fully appreciated the significance of settling a discretionary trust, beyond an appreciation for the result it may provide.⁹

A subset of issues surrounding certainty of intention is the "sham trust". The classic definition of a sham states "all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating."¹⁰ Thus, for a trust to be a sham would require both settlor and trustee to intend that the arrangement they are entering into not be a trust.¹¹ A conclusion that both the settlor and the trustee are parties to deceptive intent is not to be lightly

⁷ Certain types of property, including land, generally have additional requirements for a valid transfer.

⁸ *Minister of National Revenue v. Abla Leon* 74 DTC 6451 (FCTD).

⁹ See *supra* note 2 at paragraph 8 (FCA quote from TCC decision).

¹⁰ *Snook v. London and West Riding Investments Ltd.*, [1967] 2 QB 786 (CA) at 802 per Diplock L.J.

¹¹ *Abdel Rahman v. Chase Bank (C.I.) Trust Company Limited et.al.*, [1991] JLR 103 (Royal Court) and *In the Matter of the Esteem Settlement and the No. 52 Trust (Abacus (C.I.) Limited as Trustee)* [2002] JLR 53 (Royal Court).

drawn. In *Antle*, Miller J. expressed his view that the requirement for intentional deceit by both the settlor and trustee was not met.

I find there certainly is an element of artificiality in an arrangement where the exercise of discretion is rendered meaningless by the very nature of the strategy itself, the elaborate, but certain and fixed preordained steps...Cumulatively, these factors still cannot lead me to a conclusion that there was intentional deceit by Mr. Antle and the Trustee justifying a sham, but certainly confirms my view on the issue of the creation of a valid trust.¹²

The Federal Court of Appeal was of the view that Miller J. misconstrued the notion of intentional deception in the context of a sham. The FCA commented that the required intent is not equivalent to *mens rea* or what the tort of deceit would require. "It suffices that parties to a transaction present it as being different from what they know it to be."¹³ "...both the appellant and the trustee gave a false impression of the rights and obligations created between them. Nothing more was required in order to hold that the Trust was a sham."¹⁴

Best Practices

The lawyer assisting on the trust settlement should ensure that he meets in person or by telephone with the settlor to review the trust document and the legal implications of settling a trust. The lawyer should keep notes of that meeting to establish the settlor's knowledge of the content of the trust documents and advise the trustees that the settlor has been properly informed. Given the Federal Court of Appeal decision in *Antle*, the importance of taking these steps cannot be overstated.

Issues

If there is a concern that the settlor lacked intention to create a trust, the trust may be constituted upon a subsequent settlement of property. For example, if the trust was not properly constituted by the settlor but a gift of property to the trustees occurred thereafter, the transferor of such property may be the settlor for trust law purposes and the trust valid from the date of that subsequent transfer. Appropriate documentation (e.g. a sworn affidavit) should be secured to document certainty of intention by the subsequent settlor.¹⁵

¹² See *supra* note 2 (TCC) at paragraph 75.

¹³ *Ibid* (FCA) at paragraph 20.

¹⁴ *Ibid* paragraph 21.

¹⁵ The relationship of the subsequent settlor to the beneficiaries may give rise to attribution and other tax considerations.

Certainty of Subject Matter

Discussion

Misplaced trust settlement property is a source of great frustration upon audit of a trust's valid constitution. Paper money and valuable coins have been reputed to have vanished from trust minute books and files. Certainty of subject matter was brought into question in *Antle* where shares were the subject matter including: "suspect" directors' resolutions authorizing the share transfer, questionable delivery of the share certificates to the trustee, as well as a retained interest by Mr. Antle in the shares. Miller J. concluded that the trustee never became owner of the shares.¹⁶

Best Practices

Photocopies of the trust settlement property should be taken. When copying money, care must be taken not to commit a criminal offence.¹⁷ Money should be copied in black and white or off scale to avoid creating a "likeness" of the money but with sufficient detail that the existence of the money can be verified. Serial numbers on paper money should also be recorded in the trust deed itself or appended in a schedule of settlement property. In addition, many practitioners have the settlor and trustees execute affidavits at the time of settlement. The settlor would swear that they have settled the trust with their own money and gifted the property to the trustees with the intention of settling the trust. The trustees would swear that they have received that property from the settlor.

Many lawyers will keep original settlement property in their vaults. If the trustee is keeping the settlement property it should be kept in a secure location known to the advisors such as a safety deposit box. Lay trustees in particular must be made aware of the importance of keeping the settlement property as long as the trust is in place and ensuring it is not used to purchase assets or otherwise disbursed. A legally valid trust may exist notwithstanding that the original settlement property has gone astray but given that the CRA seems to place undue importance on the existence of original settlement property, it is easy and prudent to take steps to ensure it is properly safeguarded.

Issues

If the CRA challenges trust validity due to missing settlement property, and no subsequent gift was made to the trust (e.g. where the trustee borrows a nominal sum to acquire common shares in a freeze transaction) this creates an evidence issue as the taxpayer has the onus of proof. Accordingly, if the settlement property cannot be located, take steps to secure current affidavits from the settlor, trustee and others who may have observed or have knowledge of its transfer to the trustee. If these individuals

¹⁶ See supra note 2 at paragraph 57.

¹⁷ Criminal Code, RSC, c. C-34, section 457.

are deceased, incapable or cannot be found, contact the lawyer who set up the trust to obtain an affidavit.

TRUST ADMINISTRATION

Allocations to Beneficiaries

Discussion

Family tax planning may include the distribution or allocation of income from an *inter vivos* trust (generally taxed at the highest marginal rate) to beneficiaries who are in a lower marginal tax bracket. The Act¹⁸ permits a deduction from trust income for amounts paid or payable in the year to a beneficiary and a corresponding inclusion in the beneficiary's hands.¹⁹ In order for this deduction and inclusion to be available, the amount must have been paid in the year to the beneficiary (see "Payments to Minors") or the beneficiary must have been entitled in the year to enforce payment of the amount.²⁰

Certain types of trusts contain a requirement to pay income in the year to the beneficiary (i.e. spousal trusts, alter ego trusts) and age 40 trusts²¹ have their own mandated scheme of allocations. Accordingly no further steps are required by the trustee to deduct income from the trust and allocate it to the beneficiary for tax purposes. However, in most discretionary family trusts, positive steps must be taken by the trustee to meet the "paid or payable in the year" requirement.

Best Practices

A trustee work plan should be created to remind the trustee of key steps to be taken throughout the year. For example, the work plan should require the trustee to contact beneficiaries every December to consider allocations of income to be made before year end. If income is to be allocated, trustee minutes or a written resolution should be prepared and notice given to the beneficiary of the amount of the allocation. A promissory note²² may be issued to the beneficiary as evidence of the debt created by the

¹⁸ Income Tax Act, RSC 1985, c.1 (5th Supp), as amended ("the Act"). Unless otherwise noted all statutory references are to the Act.

¹⁹ Subsections 104(6) and (13).

²⁰ Subsection 104(24).

²¹ Subsection 104(18).

²² The CRA is reputed to be taking a view that a statute barred promissory note somehow taints or illegitimizes the proper allocation of the amount in a previous year. It is unclear how a promissory note that becomes statute barred would impact the determination of whether an amount was payable in the year in which an allocation was made and the note issued. Regardless, trustees should be aware of potential limitation issues with regard to promissory notes issued to beneficiaries. The *Limitations Act* (Ontario) 2002, S.O. 2002 c. 24 Sch. B, subsection 5(3) provides that the limitation period for a demand promissory

resolution. However, the promissory note is not a substitute for the minutes or resolution of the Trustees to allocate income without which it is not clear that the note is relevant for the allocation of income; it could be in respect of a capital allocation, a loan or repayment of debt.²³

Issues

Often, the trustee intends to allocate all of the trust's income for the year to a beneficiary. It is critical that steps are taken to evidence that the amount was payable to the beneficiary *in the year*. However, the actual amount of the income is often not determinable until some time after the end of the calendar year. In such cases, *before the end of the year* the trustee must:

- consider making allocations;
- resolve to allocate all or a portion of the income for the year to named beneficiaries;
- note the amount of income reported in the trust to that date;
- estimate the income that could be earned in the remaining period to year end; and
- notify the beneficiary in writing of their decision in this regard.

After year end the trustees should meet again, reference the pre-year end resolution and formalize, in writing, the exact amount of the allocation / distribution as reported on the T3 return.

There is no magic to the form of documentation other than it is in writing. Ideally signed minutes of a trustees' meeting or trustees' resolution should evidence the intention to make the allocation; but any written form that evidences trustee intent to allocate income should suffice. It is critical that the allocation decision, and evidence of that decision, occur before the end of the year. If there has been a failure to document a decision of the trustees to allocate income before the end of the year, the decision may be subsequently documented so long as the document does not purport to have been made contemporaneously.

Payments to Minors

Discussion

Most modern trust deeds permit trustees to make payments "to or for the benefit of" the beneficiaries. Where the beneficiary is a minor child, it is common for payments to be made from the trust to third parties for the benefit of the child. Amounts so paid are generally considered to be amounts "paid in the year to the beneficiary" for purposes of

note commences with the demand. In other provinces the limitation period may commence upon creation of the note such that some form of regular refreshment of the obligation is required.

²³ CRA document no. 9606227, March 6, 1997; and CRA document no. 9529647, February 26, 1997.

subsection 104(24). The CRA will generally consider an amount to be deductible from the trust's income under subsection 104(6) and included in the minor's income under subsection 104(13) where:²⁴

- a) the trustee *exercised his or her discretion* pursuant to the terms of the trust indenture ... to make the amount of the trust's income payable to the child in the year before the payment was made;
- b) the trustee initiated the steps to make the payment, the trustee notified the parent of the exercise of the discretion and the parent directed the trustee to pay the amount to the appropriate person before the payment was made; or the payment was made pursuant to the parent's request and direction, the parent was advised of the exercise of the discretion and payment of the amount either before or after the payment was made; and
- c) it is reasonable to consider that the payment was made in respect of an expenditure for the child's benefit...

Where a trustee makes transfers to the parents of a minor beneficiary without proper exercise of discretion and record-keeping the deduction may be denied.²⁵

Best Practices

Trustees must exercise their discretion to allocate income to a minor beneficiary prior to making the payment. This requires trustee minutes or resolutions to pre-date the actual payment.

Payments for large expenditures, such as private school fees, are generally easier to manage from a record-keeping perspective. For smaller and day-to-day expenses incurred by a parent on behalf of a minor we recommend a separate companion credit card be used. For example, when booking a family vacation, the "parent card" is used for the parent flights and the "child card" is used to pay for the child's flight. The parent can submit the credit card bill to the trustees; the trustees record the expense and reimburse the parent for appropriate expenses at their discretion.

Issues

Common issues with respect to payments to or for the benefit of minors include:

- a lack of evidence that the trustees exercised their discretion prior to making the payment; and

²⁴ See CRA Technical News No. 11, September 30, 1997.

²⁵ *Howard Langer Family Trust v. MNR*, 92 DTC 1055 and *Degrace Family Trust v. MNR*, 99 DTC 453. The CRA stated (ibid) that payments for necessities of life may be deducted from trust income without application of subsection 105(1) if the requirements set out are met.

- inadequate record-keeping.

The exercise of trustee discretion to make payments should be on the trustee work plan to review expenses regularly for reimbursement. Trustees who are not adept at bookkeeping should engage a professional accountant to assist them - even for the simplest trust accounts.

General Best Practices

The Passive Trustee

Discussion

Too often trusts are established without proper instruction to trustees. Rather, the future trustee is assured that their duties are minimal and they need not actively manage the trust property. Where the trustee has essentially given up his or her functions to a person in another jurisdiction by adopting “a policy of masterly inactivity”,²⁶ residence of a trust could be brought into question.

There is a spectrum of trustee behaviour in seeking and accepting advice from a beneficiary, settlor or protector of a trust without compromising the residence of a trust. On one end of the spectrum is the trustee who does not take interest in or inform himself about the needs and desires of the beneficiaries; this trustee is not doing his job. On the other end is the trustee who blindly accepts direction from others without exercising his own judgment; this trustee is in breach of trust. Somewhere on this spectrum is a trustee who seeks information from appropriate persons concerning the exercise of his duties and powers yet independently exercises his judgement. It is anticipated that the decision of the Federal Court of Appeal in *Garron* will clarify if and when a person other than an appointed trustee could be found to control the trust.

Best Practices

There is no substitute for proper legal advice to trustees. Every trustee should be properly instructed by counsel on their role, duties and powers as well as their liabilities and the standard of care expected of them.²⁷

The trustee work plan should address the particular needs of the beneficiaries and the nature of the trust property. These considerations will govern, among other things, the number and timing of trustee meetings, information to be obtained on the beneficiaries

²⁶ See supra note 1 at paragraph 143.

²⁷ See Richard B. Kuzyk, “Legal Influences Over Trustees of Family Trusts”, *Report of Proceedings of Forty-Fourth Tax Conference*, 1992 Tax Conference (Toronto: Canadian Tax Foundation, 1993), 17:1 – 29 for a review of legal duties and responsibilities assumed by trustees of family trusts.

and their needs, and the appropriate management of trust property. The work plan is critical to ensure that trustees turn their minds to the proper exercise of their duties and powers to meet the standard of care expected. Written trustee resolutions or minutes of meetings should evidence every step in the work plan. Situations requiring trustee attention will also arise outside the work plan from time to time.

Counsel may be engaged to assist the trustee with preparation of resolutions, minutes and other documentation periodically. While such documents are not a legal requirement – and there is much debate as to how much detail should go into documenting the trustee decision making process - CRA audit activity would indicate that some form of contemporaneous record keeping is prudent.

Issues

Trustees often have not evidenced their work in written resolutions or minutes. To the extent possible, such documents may be recreated from the trustee's own memories. However, documents so produced cannot be "back dated" so as to confuse them with contemporaneous documents.

Miscellaneous Best Practices

- Incorporate closing agendas, work plans, limitation systems and checklists into your processes. Defined processes that are consistently followed with appropriate back-up and follow-up procedures will go a long way to ensuring that important dates are not missed (e.g. interest payment deadlines, 21 year planning deadlines, T3 and other filing deadlines).
- Processes should be developed related to trust investments. For example, the trustee should be involved in reviewing investment policy statements and must regularly receive and review reports on investment activity. If an individual beneficiary or the settlor of the trust happens to use the same investment advisor as the trust, it is critical that the trustee make it very clear to the investment advisor that the trustee is the legal owner of all trust investments and, as such, must be the person contacted for all discussions and instructions with regard to trading activity.²⁸
- Trustees – and beneficiaries - must understand that a trust is not a personal bank account for beneficiaries. Funds should not be deposited to or taken out of the trust at whim. This can be a particular problem when there are multiple entities in the organization chart and the settlor or a beneficiary is used to moving money or investments around from one account to another on their own accord. Not only

²⁸ In our view it is reasonable and appropriate for the trustee to look to the settlor and those who know the beneficiaries best for advice and recommendations in discharging their fiduciary obligations with respect to investment and other decisions. However, the trustee must document having taken any such recommendations under consideration along with evidence of their independent decision making.

does this result in record keeping difficulties, but such deposits and withdrawals can have disastrous tax consequences.

- The year the trust was settled should be included in the name of the trust as a reminder of a pending 21 year deadline.
- Trustees should enter into contracts, open all bank, investment and other accounts and register legal title as “John Doe as Trustee for the Smith (2010) Family Trust”.
- Advisors should diarize a regular file review to destroy old drafts, remove irrelevant or misfiled documents and generally ensure only final executed copies of documents and appropriate supporting documents are on file. All privileged correspondence should be kept in a separate folder clearly marked as such. Since the CRA seems inclined to send out information requests to multiple parties simultaneously, it would be prudent to ensure that clients are also given clear guidance on the secure destruction of draft documents.
- We recommend filing a T3 return every year, notwithstanding CRA administrative policy.²⁹ This will start the clock ticking on potential future re-assessments. The annual filing process also ensures some level of discipline in reviewing trust accounts annually and ensuring that at minimum basic accounting records and a trial balance are maintained for the trust.
- Be very conscious when communicating by email. At best some email content can be embarrassing; at worst it can be very damaging. The “Reply to All” option is particularly problematic. Matters of privilege, confidentiality, evidence and reputation should all be borne in mind before the send button is pushed.

SUMMARY and CONSIDERATIONS IN CHOICE OF TRUSTEE

What should be apparent is that choice of trustee in today’s environment may need to be quite different than in the recent past. In reviewing CRA information requests and the best practices recommended above, it quickly becomes clear that the average lay person is likely not well equipped to take on the role of trustee without considerable and consistent support from their advisors. While this may not be an issue for families of higher net worth, for many the mere cost of setting up and maintaining a trust in this environment may well make a trust structure infeasible.³⁰

²⁹ T3 Trust Guide T4013(E) Rev. 09, “Who Should File”.

³⁰ In the vast majority of cases incorporating a trust into the family wealth plan is prudent for any number of non-tax reasons (e.g. facilitating ownership and sale of a minor’s shares without involving the public trustee; parents are uncomfortable giving potential or existing wealth outright to their children for any number of reasons; beneficiaries who are disabled, aged, living with addiction problems or those whose course of conduct has shown them to be irresponsible in handling money; and beneficiaries who are not interested in or willing to handle assets directly).

Advisors are in a much different and more difficult environment when it comes to recommending a trust as part of a family's wealth plan. They know the merits of a trust structure and yet choice of trustee has taken on a whole new dimension in ensuring initial trust validity and ongoing structural integrity.

Appendix C sets out suggested questions to ask a potential trustee. This is not intended to be a complete list, but is drawn from experience as well as CRA audit questionnaires. While the Appendix C questions may favour a professional or corporate trustee, this is often not a feasible or desirable option. Regardless, it is suggested that the questions are relevant for any one who is considering stepping into the shoes of a trustee. The concerns and practicalities underlying these questions should be reviewed with potential trustees to ensure they understand their duties as trustee, know to whom they can turn for guidance and to clearly establish proper documentation, recording keeping and accounting processes.

Finally, it is recommended that advisors meet with trustees at least annually before the end of the year. The meeting agenda would include: reviewing progress on the work plan; ensuring appropriate trustee resolutions and minutes are in place; and a general discussion about trust activity, changes in circumstances of beneficiaries, the trustee's role, and any operational or administrative concerns.

APPENDIX A

CRA INFORMATION REQUESTS

The questions below have been gathered from a variety of sources and Tax Services Offices. This is not a comprehensive list of all questions or information that has been requested by the CRA but clearly highlights that such information requests are now very detailed and comprehensive in comparison with initial audit questionnaires.

The CRA makes it clear that the information requested in an initial request is not exhaustive and that additional information and/or documentation may be required. The information / documentation is to be provided with 30 days from the date of the request letter. Copies are sufficient, with originals to be made available upon request.

Questions Addressed to Settlers

- Did you meet with the trustee to discuss creating the trust?
- How was the trustee selected?
- What was the reason for selecting this particular trustee?
- Did you provide any instructions or guidance to the trustee with respect to the acquisition or disposition of assets of the trust?

Questions Addressed to Trustees

- Who contacted you to enquire about your services as trustee?
- What date did you become trustee of this trust?
- How did you become a trustee of this trust?
- Why were you selected to become a trustee?
- Who selected you to become a trustee?
- Did you consult independent legal counsel before agreeing to become the trustee or signing any of the documents? Provide details and documentation as applicable.
- Were you given any time frames as to how long you would serve as trustee? If so, please provide details.
- Did you obtain physical possession of the property settled on the trust and retain such possession at all times?
 - If not, please explain why not and provide the name(s) of the person(s) who had physical possession of such property at any time.
 - If so, what was the date you received the property?
- What was your role, function and responsibility in regard to each transaction in the trust?
- What is the extent of your control over the trust assets?
- Do you have complete authority to do as you wish in your capacity as trustee?

- How were [trust assets] transferred to you as trustee (i.e. gifted, sold, etc.)? Provide all documentation with regards to the transfer of [specific asset].
- Who prepared the documents you signed? If fees were earned for their preparation, who paid for these documents? Please provide copies of all invoices.
- How were documents delivered to you and how were they handled by you? How did you return documents? If you have not done so, please provide copies of all documents.
- Did you obtain legal title and all rights to the property held by the trust?
 - If not, please explain why not and provide us with the names of any person who had possession of any such trust property at any time. For each such person, please provide a description of the specific rights to any property of the trust that the person held at any time.
- Did you obtain physical possession of the property held by the trust and retain such possession at all times? If not, please explain why not and provide the name(s) of the person(s) who had the physical possession of such property at any time.
- What were your roles, functions and responsibilities with the trust?
- How are decisions in relation to trust property made? Who makes these decisions? Are they documented? Who signs off on these decisions?
- Did the trust operate a bank account? If so, please provide copies of all bank statements, deposit slips and cancelled cheques (front and back) from the inception of the trust to the present time. If there are no bank accounts and/or statements, please provide a detailed listing of financial transactions of the trust (i.e. cash in, expenses, distributions, etc.)
- The trust made an election under the Income Tax Act (subsection 104(13.1)) with regards to income allocated to the beneficiaries of the trust. Please explain why this was done. What analysis did you do in making this decision? Please provide copies of your analysis. Did you receive advice from anyone in making this decision? If so, provide copies of any written advice received (i.e. email, fax, etc.).
- In respect of fees which you may have charged in your capacity as trustee, to whom did you invoice your services? What was the basis on which you did your billings for your services to the trust? Who paid you and how were you paid? Please provide us with copies of all invoices and receipts of payment for your services.
- Provide copies of all invoices issued by any accountants, tax practitioners, brokers, financial institutions, etc. relating to any services or advice provided to the trust for all years since inception.
- Who prepares the books and records of the trust and where are they located? Provide the authorization letter for the provision of accounting / tax services.
- Who prepared / authorized the financial statements of the trust? Provide copies of all the financial statements.
- Who prepared the T3 Income Tax returns?
- Provide copies of all Trustee Resolutions and Trustee since inception.

Questions Addressed to Advisors

- Provide the following documents for [period] under review:
 - Documents relating to the planning and formation of the trust
 - A schematic and / or information detailing the relationship of all related companies and trusts
 - Documentation as to how the ownership of the shares of [XCo] were obtained by the trust
 - Directors' resolutions for all dividends paid to the trust
 - Minute book of [XCo] and of the trust
 - A list of assets held by the trust
 - Provide details of any loans to or from the trust including the names of the person(s) from / to whom loans were received / given, their relationship to the trust, trustees, settlor, beneficiaries, rate of interest and conditions for repayment
 - Any and all books and records of the trust including but not limited to, bank accounts, bank statements, general ledgers, investment statements, expense reports, trial balances and reconciliations
 - Details of any life insurance policies taken by the trust, including the person or persons insured and the beneficiaries
 - If the trust owned residential properties during the review period, details of the residential properties and the residents relationship to the trustees, settlor or beneficiaries
 - Details of any trust property that may have been lent to any other part including the beneficiaries
 - All documentation (internal and external) relating to the purchase, sale, and/or transfer of all properties to and from the trust during the period under review
 - All billings / invoices issued to the trust with respect to any fees paid to the trustee and/or other parties
 - Copies of all correspondence, memorandum, faxes, electronic mails, handwritten notes, minutes and/or record of meetings and conversation etc. with respect to communications between the trust, the settlor, the beneficiaries and other parties during the periods under review
 - Any agreements, amendments to agreements, between the trustee and the settlor, including letter of wishes
- If you are of the view that the information / documents requested are covered by solicitor-client privilege, provide the following information in respect of each document or communication that you will not be providing on the basis that it is subject to solicitor client privilege:
 - Date of the document
 - Author
 - Recipient
 - Whether copies have been provided to anyone else
 - A description of the document

- Whether there are any attachments and the particulars regarding the attachments

Questions Specific to Alberta Trusts

Settlor

- Given that you and the beneficiary (spouse) of the trust are [(Province)] residents, why did you select a trustee resident in Alberta?
- Were you advised that there was an Income Tax election available that would allow the capital distribution to the [Province] resident beneficiary to be taxed in Alberta rather than in [Province]?

Trustee

- Have you at any time delegated any of your duties or discretionary powers under the trust to any other person? If so, please provide us with the name of any person to whom you delegated your powers and a copy of each such delegation of authority.
- What was the purpose of appointing an Alberta trustee?
- Have you received a letter, memorandum or other such document in which the settlor expressed his/her wishes with respect to the administration of the trust? If so, please provide copies of any such documents.
- Did you receive any advice or instructions with respect to the acquisition or disposition of assets of the trust?
 - If so, were you obligated or expected to follow such advice or instructions? If so, from whom did you receive the advice or instructions?
 - If not, please describe how you decided to do the transactions that were made in the trust.
- Are you required to obtain consent from anyone before selling, acquiring or transferring trust assets? If so, from whom?
- Is it a requirement for the trustee(s) to be resident of Alberta? If so, what is the reason for this requirement?
- Who made the decision to distribute income from the trust to the beneficiary and elect to have the income taxed in the trust during the period under review? Where were the decisions made?

APPENDIX B

CRA AUDIT QUESTIONNAIRE

The following is a CRA audit questionnaire by the Aggressive Tax Planning Section based on the T3 trust income tax and information returns being selected for review on the residency of a trust.

CRA audit questionnaire

1. How were you appointed as the trustee? Who appointed you? When were you appointed? Why were you appointed? What is your relationship to the trust? Please provide us with copies of the trustee agreement and/or contracts entered into by you.
2. What is your qualification, expertise and experience?
3. Do you receive a fee for your services? What is the amount and how is it paid? How is the amount determined? Please provide copies of all billings/invoices issued to trust with regard to your fees during the periods under review.
4. Please provide a list of your duties and responsibilities as the trustee.
5. Do you have control over the trust's investment portfolio and any other trust assets?
6. What signing and/or contracting authority do you have? Do you have the power to contract and deal with the trust advisors (i.e. accountants, lawyers etc.)?
7. Are you responsible for the management of any business or property owned by the trust? How is this done?
8. Are you responsible for banking and financing arrangements for the trust? How is this done?
9. Are you responsible for the preparation of the trust's accounts and reporting to the beneficiary? How is this done? Please provide copies of all correspondence, memorandum, faxes, electronic mails, handwritten notes, minutes and/or records of meetings and conversations etc. with respect to communications between the trustee, the settlor and the beneficiary during the periods under review.
10. How are decisions in relation to the trust property made? Where are the decisions made? Who makes these decisions? Are they documented? Who signs off on these decisions? Please provide copies of all correspondence, memorandum, electronic mails, handwritten notes, minutes and/or records of meetings and conversations etc. with respect to all decisions made by you as the trustee in relation to the trust property during the periods under review.

11. Who made the decision to distribute income from the trust to the beneficiary and elect to have the income taxed in the trust during the periods under review? Where were the decisions made? Please provide copies of all correspondence, memorandum, electronic mails, handwritten notes, minutes and/or records of meetings and conversations etc. with respect to these decisions.

Understand that this list is not exhaustive and that additional information and/or documentation may be required in order to complete the review. Please provide the requested information within thirty (30) days from the date of this letter.

APPENDIX C

QUESTIONS TO ASK A POTENTIAL TRUSTEE

General Competence

1. What are your qualifications, expertise and experience as a trustee?
 - a. personally
 - b. company / firm
2. How many trusts do you currently act for?
3. How are you, your company or firm insured?
4. Have you, your company or firm ever been involved in any litigation regarding trust assets under your control?
5. What is your fee structure?
6. What happens if you cease to exist?

Systems & Procedures

1. What systems, procedures, internal controls do you have in place to protect trust assets?
2. How and where are trustee decisions made? Who makes these decisions and how are they documented?
3. Where are the books and records of the trust kept?
4. Who prepares the trusts accounts and T3 return for the trust?
5. How do funds flow to and from the trust? What are the banking and financing arrangements?
6. What kind of regular reporting do you provide to beneficiaries and how?
7. Do you offer on-line access to books and records?
8. What, if anything, are you doing differently post-Garron & Antle?
9. How would you handle a CRA audit?

Day to Day Operations

1. What are your duties and responsibilities as trustee?
2. Are there any assets you are unwilling or unable to hold as trustee?
3. How do you manage businesses or property owned by the trust?
4. Are there any restrictions on investment advisors for the trust?
5. How do you interact with other professional advisors?
6. How private is the information the trustee has access to?
7. Will you act as co-trustee and, if so, are there any restrictions you impose?
8. Who will I have contact with? What is their availability?
9. Can you provide references from other clients/advisors?
10. Do you have access to relevant legal and tax advice?

Trust Administration Best Practices

Cindy Radu & Siân Matthews

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Agenda

- CRA audit activity
- Common issues in trust settlement and administration
- Choice of trustee considerations

CRA Audit Activity

- “Alberta” and “domestic” projects
- Questionnaires
 - Current (Appendix A)
 - 2009 (Appendix B)
- Responding
 - Should you?
 - Asking for extension
 - Consistency
 - Lay trustee issues



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Common Issues in Trust Settlement

- Certainty of Intention
 - *Antle* (TCC) re intention
 - *Antle* (FCA) re sham
 - Best practices
 - Ensuring settlor intention
 - Issues



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Common Issues in Trust Settlement

- Certainty of Subject Matter
 - Settlement property
 - How important is it?
 - Where is it?
 - Best practices
 - Copies (Criminal Code)
 - Who keeps original property?
 - Where?
 - Issues
 - Missing settlement property



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Common Issues in Trust Administration

- Distributions / Allocations to Beneficiaries
 - Paid or payable
 - In the year
 - Best practices
 - Trustee work plan
 - Pre-year end minutes / resolution
 - Issues
 - Income not known before year end
 - Pre-year end minutes / resolution not prepared



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Common Issues in Trust Administration

- Payments to minors
 - Requirements
 - Best practices
 - Trustee discretion (exercise and evidence)
 - Documentation
 - Issues
 - Lack of evidence re discretion / expenditures
 - Work plan
 - Bookkeeper



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Common Issues in Trust Administration

- General Best Practices
 - Passive trustees
 - *Garron* “masterly inactivity”
 - Best practices
 - Proper instructions to trustees
 - Work plans
 - Ongoing assistance
 - Issues
 - Subsequent documentation



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Common Issues in Trust Administrations

- General Best Practices (cont.)
 - Miscellaneous
 - Closing agendas, work plans, diary systems, checklists
 - Trust investment processes
 - Trusts as chequing accounts – NOT!
 - Naming conventions
 - Contracts, bank account, investment agreements, etc.
 - File maintenance
 - Annual T3 filing
 - Email protocols



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Considerations in Choice of Trustee

- Implications of audits and recent case law for family trusts
- Role of advisors
 - Initial meetings
 - Creating work plans
 - Assisting with trust “minute book”
 - Ongoing discussions
- Questions for trustees (Appendix C)



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