

This circular cancels and replaces Information Circular 78-5R2 dated October 2, 1987.

INTRODUCTION

The purpose of this publication is to provide information regarding the application of Section 143 of the *Income Tax Act – Communal Organizations*. Generally, a communal organization has members that live and work together; operates a business for the purpose of supporting its members; and its members do not own property in their own right as a matter of religious conviction. Refer to paragraph 27 for the definition of some of the terms used in this circular.

General

1. Subsection 143(1) provides that an inter vivos trust is deemed to exist when a congregation:
 - (a) has members who live and work together;
 - (b) does not permit its members to own property in their own right;
 - (c) requires that its members devote their working lives to the activities of the congregation; and
 - (d) carries on one or more businesses directly, or manages or controls a business agency, that carries on one or more businesses, for purposes that include supporting or sustaining its members or the members of another congregation.
2. The property of the congregation and all its business agencies is deemed to belong to the trust.
3. Where the congregation is a corporation, the corporation is deemed to be the trustee having control of the trust property. Where there is no corporation, the members of the congregation's council, committee of leaders, or other group charged with the management of the congregation are deemed to be the trustees having control of the trust property.
4. The congregation and all its business agencies are deemed to be agents for the trust in all matters relating to their business and other activities.
5. The members of the congregation are deemed to be beneficiaries under the trust.

6. In calculating the income of the trust for any taxation year, the trust may not deduct salaries, wages, or benefits of any kind paid to the members of the congregation.

7. The trust must pay tax on its taxable income for each taxation year (calendar year) at the rate specified in subsection 122(1).

8. The trustee, or trustees, have to file Form T3, *Trust Income Tax and Information Return* (T3 return) each year for the trust. This return is due no later than 90 days from the end of the calendar year. For filing information, get our income tax guide called *T3 Guide and Trust Return* (T3 guide). You can get this guide from your tax services office, our Electronic Data Distribution System, or our Internet site at: <http://www.rc.gc.ca>

Election in respect of taxable income – subsection 143(2)

9. The trust may elect to allocate its modified taxable income for the year to the families in the congregation. The trust's modified taxable income is the amount that would be its taxable income for the year if no deductions were made for expenses incurred for the support, maintenance, and satisfaction or personal needs of the members of the congregation. The income the trust allocates is deemed to be payable in the year to the beneficiaries of the trust and is deductible by the trust.

10. The trust can make the election for any taxation year. However, it has to make a new election for each year. The trust cannot make an election after the filing due date for the trust, nor rescind the election.

11. When the trust makes an election, it must allocate **all** of the trust's modified taxable income among the families in the congregation. The modified taxable income cannot be split between the trust and the beneficiaries. The allocation has to be made to each family in specified proportions as shown below in "Allocation Under Election."

Election binding on Minister

12. An election by the trust is not binding on the Minister unless:
- (a) the election is made on or before the filing due date for the trust (see 8 above);

- (b) any tax, interest, and penalties payable by the adult members specified in an election (see paragraph 15 below) have been paid within the time required by the Act; and
- (c) when calculating the taxable income of the members, no amount is deducted for a vow of perpetual poverty.

13. Each adult member specified in an election has to file an individual return if the trust allocated taxable capital gains, if the member is required to make a contribution to the Canada Pension Plan (CPP), or if tax is payable by the member for the year. This return must be filed by April 30 of the following year, or, in the case of a deceased individual, six months after the date of death of the individual, whichever is later.

Allocation Under Election

14. The trust has to initially allocate a portion of its modified taxable income to each family in the congregation for a year. After the initial allocation, the trust has to allocate the rest of its modified taxable income among the families. The congregation may allocate this difference among the families in such a manner as the congregation decides. If the congregation does not make and specify an allocation in the election, the trust must allocate a portion of the difference to each family in the congregation at the end of the year. This allocation is made based on the ratio of the number of adults in the family to the number of adults in the congregation at the end of the year.

Calculation of allocation

Where: A = the modified taxable income of the trust;
 B = the number of adult members of the congregation at the end of the year; and
 C = each adult's portion of the initial allocation.

Step 1 – Calculate each adult's portion of the initial allocation:

$$\frac{A}{1.25(B)} = C$$

Step 2 – Calculate the difference between the modified taxable income of the trust and the initial allocation:

$$A - (B \times C)$$

Step 3 – Calculate the total allocation for each family. First, calculate the initial allocation: (C × the number of adults in each family). Second, calculate the final allocation for each family (the number of adults in the family divided by the number of adults in the congregation at the end of the year), unless the congregation has made and specified an allocation in the election.

Example:

Amount of \$500,000 to be allocated for a congregation of 64 adult members in 40 families.

Step 1 – Amount calculated for each adult:

$$\frac{\$500,000}{(1.25 \times 64)} = \$ 6,250$$

Step 2 – Difference to be allocated:

$$\$500,000 - (64 \times \$6,250) = \$ 100,000$$

Step 3 – Case 1 – Congregation decides how the difference will be allocated:

Allocation to a family of two adults where the congregation allocates the difference calculated in Step 2 above to each family equally.

Initial allocation:

$$2 \times \$6,250 = \$ 12,500$$

Final allocation:

$$\frac{1}{40} \times \$100,000 = \$ 2,500$$

$$\text{Allocation to the family} = \$ 15,000$$

Step 3 – Case 2 – Congregation does not decide how the difference will be allocated:

Allocation to a family of two adults where the difference calculated in Step 2 above is allocated according to the proportion of the number of adults in the family to the number of adults in the congregation at the end of the year.

Initial allocation:

$$2 \times \$6,250 = \$ 12,500$$

$$\frac{2}{64} \times \$100,000 = \$ 3,125$$

$$\text{Allocation to the family} = \$ 15,625$$

15. The total of the amount allocated to a family is deemed to be payable in the year to, and to be received in the year by, the adult member specified in the election ("specified adult"). The specified adult is deemed to have supported the other family members, and to be entitled to relevant personal non-refundable tax credits. As long as the specified adult remains a member of that family, no other member can be specified in any later year.

16. In determining what constitutes a "family" for purposes of allocating income, an unmarried adult with no children constitutes a separate family (see 27 below). For example, two parents with three children aged 16, 19, and 21, whether the children live at home or not, constitutes three families:

- one family of two adults and one 16-year-old child;
- one family of a single 19-year-old adult; and
- one family of a single 21-year-old adult.

Election in respect of charitable donations and gifts – subsection 143(3.1)

17. The trust may elect to have its total charitable donations and Crown and cultural gifts made in a year treated as if they were not made by the trust but by the specified adults. This election allows the specified adults to use a percentage of the gifts the trust made to calculate their tax credits for charitable donations and Crown and cultural gifts.

18. If this election for gifts is made, each specified adult is deemed to have made a gift with a fair market value (FMV) equal to the FMV of the donation or gift made by the trust, multiplied by that specified adult's proportion of the total allocated income of the trust.

Example:

The trust donated property with an FMV of \$100,000 to a registered charity. The congregation has 64 adult members in 40 families. From the example in paragraph 14, the trust allocates to each family, a share of the total allocated taxable income of \$500,000. The formula to calculate each adult's share of the gift is:

$$A \times B/C$$

Where: A = FMV of the gift;

B = each specified adult's share of the total allocated amount; and

C = the total amount allocated by the trust.

Case 1 – Congregation decides how the difference will be allocated:

Allocation of income to a family of two adults: \$15,000

The share of the gift for the specified adult is:

$$\$100,000 \times \frac{15,000}{500,000} = \$ 3,000$$

Case 2 – Congregation does not decide how the difference will be allocated:

Allocation of income to a family of two adults: \$15,625

The share of the gift for the specified adult is:

$$\$100,000 \times \frac{15,625}{500,000} = \$ 3,125$$

Filing requirements

19. When completing the T3 return, follow the instructions in the T3 guide, and make sure that you:

- (a) complete all of the identification area on page 1;
- (b) identify the trust as a communal organization;
- (c) do not deduct any amount for salaries, wages, or benefits of any kind paid to any members of the congregation when calculating the trust's taxable income;
- (d) if you make an election regarding taxable income, determine the trust's modified taxable income;

- (e) if you make an election regarding donations and gifts, enter on Schedule 9, *Summary of Income Allocations and Designations to Beneficiaries*, the total amount of charitable donations and Crown and cultural gifts designated to members of the congregation; and
 - (f) if the trust is allocating business, farming, or fishing income, enter on Schedule 9, in the area called "self-employment earnings," the total amount of business, farming, and fishing income allocated, since it is considered to be self-employment income for CPP contributions.
20. If the trust does not make an election, calculate taxable income and tax payable according to the regular rules for an inter vivos trust.
21. We will credit any tax withheld from income reported by the trust against any amounts payable by the trust. We will refund any balance to the trust.
22. The trust has to complete a T3 slip, *Statement of Trust Income Allocations and Designations*, for each beneficiary (specified adult). When preparing the T3 slip, follow the instructions in the T3 guide, and make sure that you:
- (a) enter the beneficiary's name and address in the appropriate area;
 - (b) enter the beneficiary's social insurance number in box 12;
 - (c) enter the trust's complete name in the space provided, and if we have assigned an account number to the trust, enter it in box 14;
 - (d) follow the instructions for "Box 26," if some of the income in box 26 is from farming, fishing, or business activities;
 - (e) enter the beneficiary's designated portion of charitable donations and Crown and cultural gifts in box 36;
 - (f) enter in the footnotes area the amount in box 36 that is a cultural gift; and
 - (g) enter in the footnotes area the amount in box 36 that is a Crown gift made before February 19, 1997, or made after February 18, 1997, under a written agreement entered into before February 19, 1997, and the date the gift was made.
23. The income the trust allocates will be considered to be the income of the beneficiaries for the year from a trust. In most cases, this income is shown as "Other Income" in box 26 of the T3 slip. However, the trust can designate certain income or credit amounts to the beneficiaries. When a particular type of income is designated, it retains its identity. This designation may allow the beneficiary to take advantage of some deductions or credits that apply to the designated amounts. These amounts include dividend income from taxable Canadian corporations, net taxable capital gains,

foreign income and foreign taxes paid, investment tax credits, and charitable donations and Crown and cultural gifts. These designated amounts are shown in specific boxes or as footnotes on the T3 slip. The income from the trust does not qualify as earned income for registered retirement savings plan contributions. However, business income allocated by the trust is considered to be self-employment earnings for Canada Pension Plan contributions.

24. When completing the individual return, follow the instructions in the *General Income Tax and Benefit Guide*, and make sure that you:

- (a) complete the identification area in detail, including social insurance number, marital status, and date of birth;
- (b) report Old Age Security received. If the pension is not applied for, enter "NIL" on the applicable line;
- (c) enter dividends from taxable Canadian corporations on the applicable line. There must be an entry on this line to allow the dividend tax credit;
- (d) enter capital gains on the appropriate lines of Schedule 3, *Capital Gains (or Losses)*. The T3 slip provided by the communal organization should provide details of the correct amounts to report;
- (e) report the amount shown as "Other Income" on the T3 slip on the applicable line, after reducing it by the amount reported as farming or fishing income;
- (f) report farming or fishing income on the applicable lines. The income reported by the trust as a footnote on the T3 slip is to be entered at both the gross and net income lines;
- (g) report charitable donations and Crown and cultural gifts on the applicable lines of Schedule 9, *Donations and Gifts*; and
- (h) where the individual return is filed on paper, there should be a letter attached or an indication that the return is being filed for a member of a communal organization. If the returns are being filed electronically, consult the applicable software instructions or user guide to ensure that the returns are properly identified.

25. Residents of provinces or territories that have provincial or territorial tax credits should complete the applicable tax credit form.

26. We will mail assessment or reassessment notices, refunds, or notices of amounts payable, to the individual members at the address indicated on their return.

Definitions

27. In this circular, the following definitions apply:

Adult means an individual who has reached 18 years of age or is married.

Business agency means a corporation, trust, or other person over which the congregation has effective management or control, that carries on one or more businesses for purposes that include supporting or sustaining its members or the members of another congregation.

Congregation means a community, society, or body of individuals, whether incorporated or not, that adheres to the practices and beliefs of, and operates according to the principles of, the religious organization of which it is a constituent part.

Family means:

- in the case of an unmarried adult, that person and that person's unmarried children who are not adults; and
- in the case of a married adult, that person, that person's spouse, and the unmarried children of either or both of them who are not adults,

but does not include an individual who is included in any other family or who is not a member of the congregation in which the family is included.

Member of a congregation means:

- an adult, living with the members of the congregation, who conforms to the practices of the religious organization of which the congregation is a constituent part, whether or not that person has been formally accepted into the organization; and
- an unmarried child, other than an adult, of an adult referred to above, if the child lives with the members of the congregation.

Religious organization means an organization, other than a registered charity, of which a congregation is a constituent part, that adheres to beliefs, evidenced by the religious and philosophical tenets of the organization, that include a belief in the existence of a supreme being.

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