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**Planned Giving for High Net Worth Clients**

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**By Karen J. Cooper and Theresa L.M. Man**

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# Planned Giving for High Net Worth Clients

Karen J. Cooper and Theresa L.M. Man

## Table of Contents

A. Introduction.....	1
B. Elimination of Taxable Capital Gains in Respect of Certain Gifts .....	2
1. Previous Provisions.....	2
2. Budget 2006.....	5
3. Flow-Through Shares.....	7
4. Valuation .....	8
5. Provincial Rules .....	10
6. Conclusion .....	10
C. Charitable Remainder Trusts .....	10
1. CRA's General Position .....	12
2. Benefits of Making a Gift through a Charitable Remainder Trust.....	14
3. Concerns Regarding Charitable Remainder Trusts.....	15
4. Conclusion .....	16
D. Charitable Donations Made Through Wills .....	17
1. Benefits of Making Charitable Gifts by Will.....	17
2. Application of Subsection 118.1(5) .....	18
3. Gifts Made by a Testator Without Involving any Trusts.....	19
4. Gifts Made by a Testator Involving Trusts.....	23
5. Conclusion .....	26
E. Use of Private Foundations .....	26
1. Advantages of Using Private Foundations.....	27
2. Limitations on Using Private Foundations .....	29
3. Factors to Consider When Establishing a Private Foundation.....	33

## **Planned Giving for High Net Worth Clients**

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### **A. Introduction**

Planned giving generally involves making a charitable gift in such a way that maximizes tax and other financial benefits for your clients. For most clients, planned giving will involve identifying select charities to receive bequests in order to offset certain tax consequence on death, perhaps determining the optimal annual giving amount to avoid the effect of a shift to a higher tax bracket, or in some instances structuring a more significant one-time donation to offset the impact of a particular tax event, such as a transaction that will trigger substantial un-sheltered taxable capital gains. While many planned gifts are made through bequests in a will, there are other options such as life insurance, using cash to create a charitable gift annuity, or gifts of property such as stocks, real estate, or art.

This paper deals with selected topics on planned giving for high net worth clients with an emphasis on the potential tax consequences of the various structures and Canada Revenue Agency (“CRA”) technical interpretations related thereto. Beginning with the fairly straight forward considerations involved in taking advantage of the recent elimination of taxable capital gains in respect of donations of publicly listed shares, including flow-through shares, the discussion progresses to more complex structures involving charitable remainder trusts and gifts by wills. Finally, for the clients wishing to follow in the path of recent high profile philanthropists, the paper sets out the main considerations involved in establishing a private foundation. Other structures that this paper does not deal with, but which should be considered for high net worth clients include gifts of life insurance, charitable annuities, and using joint partner trust or alter ego trusts as will substitutes.

## **B. Elimination of Taxable Capital Gains in Respect of Certain Gifts**

In the 2006 federal budget released on May 2, 2006,<sup>1</sup> the Conservative government upheld its commitment to remove the capital gains tax on listed securities donated to charities<sup>2</sup> and extended this measure to gifts of ecologically sensitive land, effective immediately. These measures have impacted, and will continue to significantly impact, the charitable sector. While these measures do not apply at present to private foundations, the government indicated in the budget that it will consult with the sector to develop some self-dealing rules to safeguard against potential conflicts of interest. Both the Canadian Association of Gift Planners and the Association of Fundraising Professionals have applauded these changes indicating that they will encourage increased charitable giving in Canada. Most recently, the Toronto General Hospital received a donation of \$37 million and the UJA Federation of Greater Toronto received \$50 million, both donations a direct result of the new measures.<sup>3</sup> The following provides a brief discussion of the current regime applicable to such donations in order to better understand the new measures and their impact on donors and charities.

### **1. Previous Provisions**

Under paragraph 69(1)(b) of the *Income Tax Act (Canada)*<sup>4</sup> (the “Act”), a taxpayer who disposes of property by way of gift is generally deemed to have received proceeds of disposition equal to the fair market value (“FMV”) of the property at that time. If the FMV of the property exceeds its adjusted cost base (“ACB”),<sup>5</sup> the donor will realize a capital gain as a result of such a disposition. For most gifts of property, the usual rules in respect of the disposition of capital property apply and 50% of the capital gain is included in income for the

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<sup>1</sup> Canada, Department of Finance, 2006 Budget, May 2, 2006. For the relevant section of the budget 2006 documents, see <http://www.fin.gc.ca/budget06/bp/bpc3ce.htm#donations>.

<sup>2</sup> See Karen J. Cooper, “Proposed Elimination of Tax on Gifts of Public Company Shares,” *Charity Law Bulletin* No. 89, March 9, 2006 for a discussion of the commitment.

<sup>3</sup> “Cardiac centre gets \$37M gift,” *CBC News*, May 30, 2006  
(online: at <http://www.cbc.ca/story/science/national/2006/05/30/munk.html>.)

<sup>4</sup> R.S.C. 1985, c. 1 (5th Supp.), as amended (hereinafter referred to as the “Act”).

<sup>5</sup> The ACB of property is usually the cost of a property plus any expenses incurred to acquire it, such as commissions and legal fees. The cost of a capital property is its actual or deemed cost, depending on the type of property and how it was acquired. For more information on ACB, see section 53 of the Act and CRA, *Interpretation Bulletin* IT-456R, “Capital Property - Some Adjustments to Cost Base,” July 9, 1990 and its Special Release, CRA, *Interpretation Bulletin* IT-456SR, “Capital Property “ Some Adjustments to Cost Base,” October 30, 1992.

year and is subject to tax.<sup>6</sup> For example, if an individual gifts private company shares to a registered charity for which she paid \$100 for (the ACB) and which now have a FMV of \$1,000, she will realize a capital gain of \$900 and a taxable capital gain (the amount she will have to include in her taxable income) of \$450. Assuming that she is taxed at the top marginal tax rate of 46%,<sup>7</sup> she would pay \$207 in tax on the donation. Of course, she will also be able to claim a donation tax credit pursuant to subsection 118.1(3) for the entire amount of the gift (\$1,000 - assuming that this is her only donation, the value of the tax credit would be about \$460).<sup>8</sup> The calculation would be the same if she donated land, which does not qualify as an ecological gift, with an ACB of \$100 and a FMV of \$1000.<sup>9</sup> The donation tax credit of \$460 will offset the impact of the taxable capital gain, but the donation tax credit would have had a greater impact on her tax situation if she had donated cash.

In the 1997 budget, Parliament enacted paragraph 38(a.1) of the Act, which reduces the inclusion rate on capital gains arising from a gift of various types of property,<sup>10</sup> including

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<sup>6</sup> Paragraph 38(a).

<sup>7</sup> The 2006 budget has also reduced the lowest tax rate, but we have not made any adjustments to the top marginal tax rate.

<sup>8</sup> We have used the marginal rate of 46%, the federal credit would be \$262 using the new effective bottom rate for 2006 of 15.25%.

<sup>9</sup> See definition of “total ecological gifts” in subsection 118.1(1) and “ecological gifts” in subsection 110.1(1). To make an ecological gift, the Act requires that Environment Canada or a designated authority certify the following: that the land, including a servitude, covenant or easement, is ecologically sensitive and its conservation and protection is important to the preservation of Canada’s environmental heritage; that the recipient is qualified to receive the gift, eg. territorial, provincial or federal departments or agencies, a municipality, or a registered charity whose main purpose is the conservation and protection of the environment; and what the fair market value of the gift is.

See Karen J. Cooper, “Creating a Green Legacy: The Ecological Gifts Program,” *Charity Law Bulletin* No. 81, December 14, 2005 (online: [www.charitylaw.ca](http://www.charitylaw.ca)) for a detailed discussion of provisions related to donations of ecologically sensitive land.

<sup>10</sup> Paragraph 38(a.1) applies to a gift of “a share, debt obligation or right listed on a prescribed stock exchange, a share of the capital stock of a mutual fund corporation, a unit of a mutual fund trust, an interest in a related segregated fund trust (within the meaning assigned by paragraph 138.1(1)(a)) or a prescribed debt obligation.”

publicly traded shares, where the gift is to a qualified donee<sup>11</sup> other than a private foundation.<sup>12</sup> Paragraph 38(a.2), providing for the same treatment with respect to ecological gifts, was introduced by the 2000 budget, effective February 27, 2000. The inclusion rate for both types of property was one-half of the usual inclusion rate for capital gains, for taxations years after the transitional provisions relating to changes to the usual rate in 2000 the inclusions rate was 25% instead of the usual rate of 50%.

In contrast to the example above, a donation under the previous provisions of publicly traded shares or an ecological gift with an ACB of \$100 and a FMV of \$1,000 to a registered charity, other than a private foundation, resulted in a taxable capital gain of only \$225 (25% of \$900). The tax on the capital gain would have been \$103, again to be offset by the donation tax credit of \$460. The donation tax credit would have had a greater impact on the donor's tax situation had she donated cash, but she is better off than if she donated private corporation shares or land which does not qualify as an ecological gift.

In a recent Special Report authored by Don Drummond, Senior Vice-President and Chief Economist,<sup>13</sup> TD Economics notes that from 1997 to 2000 (immediately after the reduction of the capital gains inclusion rate on gifts of listed securities to 25%) gifts of publicly traded securities to charities increased from \$69.1 million to \$200.3 million and that the share of total donations represented by stocks increased from 1.6% to 3.9% of all donations. However, many in the charitable sector had noted that the fact that the transactions resulted in some tax payable because of the inclusion of taxable capital gains, albeit

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<sup>11</sup> Subsection 149.1(1) of the Act defines "qualified donees" to include donees described in sections 110.1 and 118.1 of the Act: a registered charity; a registered Canadian amateur athletic association; a housing corporation resident in Canada constituted exclusively to provide low-cost housing for the aged; a Canadian municipality; the United Nations and its agencies; a prescribed university that is outside Canada; a charitable organization outside Canada to which Her Majesty in right of Canada has made a gift; and Her Majesty in right of Canada or a province. It has also been proposed to expand the list of "qualified donees" as defined in subsection 149.1(1) to include municipal or public bodies performing a function of government in Canada.

<sup>12</sup> In answer to a question at the 1999 APFF Conference (question 12 of the Round Table on Federal Taxation), the Department of Finance indicated that the reduction had not been extended to private foundations because it did not "seem appropriate to ask taxpayers to absorb the bulk of the cost of a gift to a private foundation, which, by its very nature, usually pursues limited objectives that Canadians in general do not necessarily support."

<sup>13</sup> Don Drummond, "Donating Shares to Canadian Charities About to Become Highly Attractive," *TD Economics Special Report* (TD Bank Financial Group, February 8, 2006) (online: [http://www.td.com/economics/special/dd0206\\_charity.pdf](http://www.td.com/economics/special/dd0206_charity.pdf).)

completely offset by the donation tax credit, had a chilling effect on many donations of publicly listed securities or ecologically sensitive land.

It is important to note that the reduced, and ultimately eliminated, inclusion rate for such donations applies only to donations to qualified donees, other than private foundations. In 1999 a question was posed to CRA at the CAGP Gift Planning Symposium with respect to the application of these rules in the context of a charitable remainder trust (see detailed discussion below) such that publicly listed securities are settled in a trust with a remainder interest irrevocably given to a charity. CRA indicated its view that since the settlor/donor is disposing of the listed securities to a trust, which is not a qualified donee for this purpose, subsection 38(a.1) would not apply to reduce the inclusion rate in respect of the taxable capital gain arising on the disposition.<sup>14</sup>

## **2. Budget 2006**

In the 2006 budget, the federal government completely eliminated the capital gains tax on certain gifts of publicly listed securities and ecologically sensitive land, measures which it maintained would provide the charitable sector with a “powerful set of tools” for raising funds and encouraging charitable giving. Subsections 38(a.1) and (a.2) were amended to provide that no portion of the capital gain in respect of such gifts, made after May 1, 2006, would be included in computing the donor’s taxable capital gains. As a result, donors would not be taxed on any of the capital gain accrued on the donated property and would receive the full benefit of the donation tax credit on the donation. In contrast to the example above, a donation of publicly traded shares or an ecological gift with an ACB of \$100 and a FMV of \$1,000 will result in no taxable capital gain. Therefore, the entire amount of the donation tax credit of \$262 will be available to be used against other sources of income. In effect, the government proposal would mean that the tax benefit arising from a gift of publicly traded securities or ecologically sensitive land would be the same as if it were a gift of cash.

The government expects that the new measures will result in an increase of about \$300 million in annual donations. The budget documents suggest that by completely eliminating the capital gains tax on such donations, the donors’ cost of making the donation will also decrease from 47% (the cost if the current rules continued to exist) to 40% or, in other words, the tax assistance provided by the government to encourage such donations will increase from 53% to

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<sup>14</sup> Question 4, CAGP Gift Planning Symposium - Round Table Questions & Answers (September 1999).

60%.<sup>15</sup> This may result in a net benefit to the donor for choosing to donate publicly traded shares, or ecologically sensitive land, instead of cash, as more explicitly explained below.

Don Drummond, in a TD Special Report,<sup>16</sup> compares a cash gift of \$100 to a gift of publicly traded shares with an ACB of \$40 and a FMV of \$100 (see Table 1). A charitable gift of \$100 cash will cost the donor \$54 after the donation tax credit (at the top marginal tax rate of 46%), but a gift of \$100 in shares will cost only \$40. The donor will have paid \$40 for the shares initially, but will receive a donation tax credit of \$46. Granted, the donor is foregoing the benefit of the increase in value of the security (from \$40 to \$100), but the donor is also avoiding the tax on that increase (\$14). “This seems like too good a deal for Canadians not to respond to in a major way,” says Drummond. “First, if there is an option, it is much more cost-effective to donate securities rather than cash. Second, total giving should increase greatly. The donor gets to determine where the money goes (provided it is a registered public charity), yet pays well less than half the cost.”

Table 1

<b>TAX ASSISTANCE FOR CHARITABLE DONATIONS BY INDIVIDUALS Of Cash Compared to Donations of Publicly Traded Securities</b>			
	Type of Donation		
	Cash	Publicly Traded Securities Donated to Public Charities	
		Current Regime	Conservative Proposal
Fair Market Value of Donation	\$100.00	\$100.00	\$100.00
Top Marginal Tax Rate	46%	46%	46%
Value of Charitable Donations Credit (A)	\$46.00	\$46.00	\$46.00
Typical Cost Base of Security		\$40.00	\$40.00
Capital Gain on Security		\$60.00	\$60.00
Capital Gain Tax if Sold, not Donated		\$14.00	\$14.00
Tax Saved Due to Incentive (B)		\$7.00	\$14.00
Total Tax Assistance (A + B)	\$46.00	\$53.00	\$60.00
Cost of Donation to Donor	\$54.00	\$47.00	\$40.00
Reproduced with permission from TD Bank Financial Group, TD Economics Special Report dated February 8, 2006, by Don Drummond. <sup>17</sup> Original Source: Department of Finance			

Many members of the charitable sector lobbied to have these measures extended to

<sup>15</sup> The budget Plan documents assert that this tax assistance is greater than that afforded by the United States.

<sup>16</sup> *Supra* note 13.

<sup>17</sup> *Ibid.*

gifts of publicly traded securities to private foundations, but the current restriction to donations to charitable organizations and public foundations remains.<sup>18</sup> However, the government indicated in the budget that it will consult with the sector to develop self-dealing rules to safeguard against potential conflicts of interest.

As a consequence of the amendments to paragraphs 38(a.1) and 38(a.2), amendments have been made to paragraph 53(1)(e) to increase the ACB of a partnership interest and to paragraph 110(1)(d.1) in respect of qualifying donations of securities acquired through an employee stock option. The amendment to paragraph 110(1)(d) is intended to ensure that donations of securities acquired through an employee stock option agreement (or the donation of the proceeds of disposition of such shares) receive the same treatment as other gifts of publicly traded shares. The effect of the amendment is to eliminate any tax on the employment benefit associated with the acquisition of securities under an employee stock option where the securities or proceeds of disposition are donated to a registered charity.

### **3. Flow-Through Shares**

Flow-through shares (sometimes referred to as “FTS”) are tax-based financing incentives available only to the oil and gas and mining sectors. The current rules effectively permit corporations to renounce or “flow-through” income tax deductions associated with certain activities to shareholders in exchange for the sale of their shares.<sup>19</sup> A flow-through share is generally a financing arrangement whereby an investor/shareholder will invest in exploration by providing funds to a corporation that uses them to incur Canadian exploration expenses (“CEE”), Canadian development expenses (“CDE”) or Canadian oil and gas property expenses (“COGPE”). The investor receives shares issued by the corporation as consideration and the deductions available to the corporation in relation to these resource expenditures are flowed-through to the shareholders who have provided the funding for the expenditures.<sup>20</sup> The expenditures deducted by the investor reduce the cost base of the shares held. Once the exploration is complete, investors typically exchange the flow-through shares for normal securities of the issuer (on a tax deferred basis). Since flow-through shares are generally deemed to have an ACB of nil,<sup>21</sup> a significant capital gain will normally occur when

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<sup>18</sup> Paragraph 38(a.1).

<sup>19</sup> Subsection 66(12.6).

<sup>20</sup> Greg Johnson, “A Practical Guide to the Flow-Through Share Rules” 2002 *Canadian Petroleum Tax Journal*, vol. 15.

<sup>21</sup> Subsection 66.3(3).

the securities are sold.

The impact of the elimination of the tax on capital gains accruing on donations of publicly traded securities when coupled with tax incentives on flow-through shares issued by companies in the resource sector has generated great interest and planning opportunities for investors in this sector.<sup>22</sup> Assume that the investor, instead of purchasing non-FTS securities, acquires \$1,000 of FTS of a publicly listed corporation. Over the course of the exploration period, the investor will be entitled to \$1,000 in flowed-through deductions related to the exploration expenses resulting in tax savings of about \$460 (assuming again a 46% marginal tax rate). At this point, the \$1,000 FTS will have cost only \$540. When exploration is completed and the investor has claimed the maximum possible amount of exploration deductions, the shares may be gifted to a qualified donee, other than a private foundation. Assuming that the value of the shares remains \$1,000, the investor will be entitled to a federal donation tax credit in respect of the \$1,000 donation of \$262, which results in another tax savings of about \$460, and will not be taxed on the capital gain. As a result, the investment and, thereafter, donation to charity of \$1,000 will have only cost the investor/donor \$80.<sup>23</sup>

Advisors to donors and charities with respect to such gifts should be careful when considering such gifts since many FTS are subject to hold periods, may not retain their value during the hold period, and may not be marketable upon the expiration of the hold period.

#### **4. Valuation**

It is important for the purposes of valuation to determine the date of the gift of publicly traded shares. Shares may be transferred to a charity in certificate form which may be mailed or hand-delivered to the charity or, alternatively, the shares are more often transferred electronically from the donor's account to the charity's account. If an endorsed share certificate or an unendorsed share certificate accompanied by a signed stock power is hand-delivered to the charity, CRA considers the gift to have been made at the time the charity receives and accepts the gift. Where the share certificate is mailed to the charity, the deeming rule in paragraph 248(7)(a) of the Act applies to deem the charity to have received the share certificate on the day it was mailed, provided that the charity accepts the gift.<sup>24</sup> With respect

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<sup>22</sup> Tim Cestnick, "Flow-through mining shares can produce charitable bonanza" *Globe and Mail* (8 July 2006).

<sup>23</sup> CRA has considered a donation of flow-through shares, but did not rule on the tax consequences of the donation (CRA Advance Income Tax Ruling, document number 2003-002905).

<sup>24</sup> CRA, document number 2000-004374, January 17, 2001.

to electronic transfers, which can take up to several days to complete depending on the procedures used by the brokerages involved, the Act does not specifically contemplate this manner of gifting shares. However, CRA has indicated that, as a general rule, the date of a gift of electronically transferred shares is the date the shares are received in the charity's account.

Because the Act also does not provide guidance in determining how a gift of shares should be valued, CRA has, as a general rule, accepted the use of the closing bid price of the share on the date it is received or the mid-point between the high and the low trading prices for the day, whichever provides the best indicator, given the circumstances, of fair market value on normal and active market trading.<sup>25</sup> However, a careful review of the facts of each situation should be made to determine the “fair market value” including the size of the block of shares in relation to the whole, the volume traded, the attributes of the shares, whether the donor had control or was a minority shareholder, whether there were any restrictions on the transferability of the shares, and whether the shares were thinly traded, requiring a look at trades over a longer period of time. For the purposes of valuation, we recommend that the gift agreement related to the donation set out in detail the method of valuation used and provide for a price adjustment clause should an issue arise with CRA with respect to the valuation.

Charities which anticipate receiving such gifts and which have not developed a policy in respect of receipt of donations of publicly traded shares should do so at their earliest opportunity, taking into consideration the guidance provided in *Registered Charities Newsletter* No. 12.<sup>26</sup> Generally, such a policy will require that with respect to electronic transfers the donor instruct their broker to transfer the shares directly to an investment account which the charity has set up with their own broker and that the transaction be carried out electronically where possible. Any policy with respect to receipt of publicly traded shares should deal with these issues, as well as consider under which circumstances the organization might refuse to accept such a gift, for example where the business or activities of the corporation conflict with objects and values of the organization.

With respect to ecological gifts, the date of the gift will be the date that the gift is completed, usually when title to the land is transferred or a conservation easement is registered, and the fair market value of the gift is determined by the Minister of the Environment, who

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<sup>25</sup> CRA, *Registered Charities Newsletter* No. 12 (Spring 2002) (online: <http://www.cra-arc.gc.ca/E/pub/tg/charitiesnews-12/news12-e.html>). See also paragraph 3702(1)(b) of *Income Tax Regulations*.

<sup>26</sup> *Ibid.*

issues a certificate which is applicable for the two-year period following the determination.<sup>27</sup>

## **5. Provincial Rules**

In an announcement dated August 3, 2006,<sup>28</sup> the Ontario Ministry of Finance indicated that it would introduce legislative measures to ensure that the provincial tax treatment of donations of publicly-traded shares and ecological gifts would parallel the federal measures announced in the 2006 federal budget, and that both would be exempt from the provincial corporate minimum tax. Similarly, the Quebec government confirmed that it would ensure that measures are introduced to eliminate the provincial tax on capital gains resulting from gifts of publicly-traded shares and ecological gifts.<sup>29</sup> In addition, as part of the 2006-2007 provincial budget, the government extended similar capital gains treatment to gifts of musical instruments to educational institutions and added a new category of organizations authorized to issue provincial donations receipts: cultural or communications organizations.<sup>30</sup>

## **6. Conclusion**

Given the substantial tax benefit of avoiding any capital gains tax on donations of publicly listed securities, particularly flow-through shares, and ecologically sensitive land, it is important for charities and their advisors to become familiar with the impact of these changes in order to ensure that donors properly understand the tax consequences of choosing to donate such property. In addition, charities and advisors should continue to monitor changes to the Act in this area with respect to the extension of these measures to private foundations and other types of property, in particular to real property.<sup>31</sup>

## **C. Charitable Remainder Trusts**

While considerable changes have been made during the last ten (10) years to many of

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<sup>27</sup> Subsections 118.1(10.1) and (12).

<sup>28</sup> Ontario, Ministry of Finance, *Tax Information Bulletin*, "Supporting Donations To Charities And Gifts Of Ecologically Sensitive Land," August 2006. (online: <http://www.fin.gov.on.ca/english/tax/2006/infdonate.html>).

<sup>29</sup> Quebec, Finances Quebec, *Bulletin d'information*, "Harmonisation à certaines mesures du Budget fédéral du 2 mai 2006 et autres mesures fiscales," June 29, 2006. (online: <http://www.finances.gouv.qc.ca/fr/documents/bulletin/pdf/bi2006-2-f-b.pdf>).

<sup>30</sup> For details, please see [http://www.revenu.gouv.qc.ca/eng/ministere/centre\\_information/nf/nf2006/in-136\\_72/bonif\\_traitement\\_fiscal\\_admissible\\_dons.asp](http://www.revenu.gouv.qc.ca/eng/ministere/centre_information/nf/nf2006/in-136_72/bonif_traitement_fiscal_admissible_dons.asp).

<sup>31</sup> For example, see the recommendations in the recent submission by the CAGP to the Parliamentary Standing Committee on Finance on September 21, 2006.

the rules related to charitable donations, including the rules with respect to certain gifts of capital property outlined above, the rules related to charitable remainder trusts have not kept pace. Further, since charitable remainder trusts are not expressly provided for in the Act, many of the rules are based on CRA technical interpretations and administrative positions. *Interpretation Bulletin* IT-226R, “Gift to a Charity of a Residual Interest in Real Property or an Equitable in a Trust” (“IT-226R”),<sup>32</sup> which sets out the basis upon which CRA will accept a gift of a residual interest in real property through a charitable remainder trust, was last revised on November 29, 1991 and its position has been publicly under review since at least 1998.<sup>33</sup> Nonetheless, a charitable remainder trust provides many planning opportunities for donors during their lifetime and upon death.

A charitable remainder trust is an irrevocable trust which has been created by a settlor/donor who gifts a residual (or remainder) interest in a property to a trust for the benefit of a registered charity or qualified donee (collectively referred to in the remainder of this section as a “charity”) while retaining the right to use and enjoy the property, including the right to receive income from the property for a specified period (usually the settlor’s life).<sup>34</sup> The settlor has a present “life interest” in the property, which includes the right to receive income from the property and which will expire upon the death of the settlor, and a charity receives an equitable future interest in the trust consisting of the residue or remainder of the property existing at the time the life interest expires. CRA will accept the immediate issuance of a donation tax receipt to the settlor/donor for the gift of the residual interest that is made through the charitable remainder trust in certain limited circumstances,<sup>35</sup> thus enabling the settlor to obtain the tax benefit of the gift even though the charity may not actually receive the property until the future death of the settlor. The receipt will generally be for the present value of the property the charity will receive when the trust is terminated, a calculation based

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<sup>32</sup> November 29, 1991 (online: <http://www.cra-arc.gc.ca/E/pub/tp/it226r/README.html>).

<sup>33</sup> CRA document number 9807185, October 29, 1998; see also CRA document number 1999-0006995, February 15, 2000.

<sup>34</sup> The specified period could be a number of years, the settlor’s life, the life of another person, or even the joint lives of the settlor and the settlor’s spouse.

<sup>35</sup> Detailed in IT-226R and other CRA administrative documents discussed in detail below.

on the settlor's age and the value of the property at the time the trust is settled.<sup>36</sup>

## **1. CRA's General Position**

In IT-226R, CRA sets out the basic requirements for a donation of a residual interest in real property or of an equitable interest in a trust to qualify as a gift for the purposes of the donation tax deduction in subsection 110.1(1) or credit in subsection 118.1(1).<sup>37</sup> The interest in the trust must be given to the charity voluntarily, with no expectation of right, privilege, material benefit or advantage to the settlor or a person designated by the settlor. The transfer of the property to the charity must be irrevocable and the property must vest with the charity at the time of transfer such that the right may not be taken away from the charity at a future date. A gift will be considered to have vested with the charity if the charitable recipient is ascertainable and in existence at the time of the transfer, if the size of the beneficiaries' interests are ascertained, and if any conditions attached to the gift are satisfied. It must also be evident that the recipient organization will eventually receive full ownership and possession of the property transferred.<sup>38</sup>

One of the principal concerns identified in the CRA administrative documents is the requirement that the value of the gift be ascertainable at the time of that the trust is settled and that there be no possibility during the existence of the life interest of encroachment (if there was an ability to encroach, the value of the gift to the charity would diminish).<sup>39</sup> With respect to the issue of encroachment, CRA has indicated that if remuneration or fees are to be paid to a financial institution or other investment managers, they must be paid out of the income and not the capital of the trust.<sup>40</sup> In addition, distributions of unrealized capital gains and returns of capital are considered encroachments on capital.<sup>41</sup>

In IT-226R and other documents, CRA has indicated that the method of valuing the residual interest will vary according to the type of gift, the fair market value of the property,

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<sup>36</sup> This was the situation in *O'Brien Estate v. Canada (M.N.R.)*, 91 D.T.C. 1349 (T.C.C.), where the taxpayer's will provided for a life interest for the taxpayer's nephew and a remainder interest for a charity. The Minister disallowed a claim by the executors for a donation deduction in the amount of the value of the remainder interest. The Tax Court of Canada allowed the appeal.

<sup>37</sup> Paragraph 2, *supra* note 32.

<sup>38</sup> See also CRA document number 1999-000699, *supra* note 33.

<sup>39</sup> IT-226R, *supra* note 32, paragraphs 3 and 6.

<sup>40</sup> CRA document number 9414195, September 21, 1994.

<sup>41</sup> CRA document number 2001-008682, July 24, 2001.

current interest rates, the life expectancy of any life tenants, current term tables, anticipated future economic conditions and any other relevant factors.<sup>42</sup> To arrive at a value of the residual interest, one method suggested was to value the life interest or interest retained by applying an appropriate discount rate to the fair market value of the property transferred and the life expectancy of the life tenant and deduct this amount from the fair market value of the property transferred.<sup>43</sup> CRA has indicated that prescribed interest rates are not always appropriate discount rates, depending upon the nature of the investments being transferred<sup>44</sup> and that a transfer of private corporation shares or units in a mutual fund trust may be very difficult to value.<sup>45</sup>

It is also CRA's view that when property is transferred to a charitable remainder trust, it is the entire property, consisting of both the life interest and the residual interest, which is transferred to the trust and which results in a disposition of the entire property for the purpose of determining whether the settlor has realized a capital gain or loss.<sup>46</sup> The proceeds of disposition of the property to the settlor and the acquisition cost of the property to the trust will be the fair market value of the property at the time of the transfer to the trust and is not discounted in any manner.<sup>47</sup> However, paragraph 8 of IT-226R provides that the settlor would be eligible to make an election under subsection 118.1(6) the Act between the adjusted cost base and the fair market value of the property which would be both the proceeds of disposition of the property and the amount of the gift.<sup>48</sup> In a technical interpretation issued in 2000, CRA acknowledged that this administrative position is contrary to the technical wording in the provision, which should apply only to a transfer to a charity and not a trust, and indicated that paragraph 8 of IT-226R was under review. In addition, CRA clarified that, for

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<sup>42</sup> IT-226R, *supra* note 32, paragraph 5; CRA document number 9414195, *supra* note 40; CRA document number 1999-0006995, *supra* note 33. Other factors cited in CRA document number 2001-0087375, March 18, 2002, include the ability of the life tenant to use the property as security for debts, costs of potential re-zoning or alteration of the property for use by the charity, and requirements to maintain and insure the property. CRA has repeatedly refused requests to provide some guidance with respect to specific mortality tables or discount rates: question 1, *1999 Gift Planner Symposium*, CRA document number 2000-M020417, January 17, 2000.

<sup>43</sup> CRA document number 9429135, January 26, 1995.

<sup>44</sup> *Ibid.*; CRA document number 9603885, February 26, 1996.

<sup>45</sup> CRA document number 1999-0006945, February 15, 2000; CRA document 2001-008682, *supra* note 41.

<sup>46</sup> *Ibid.*; *Income Tax Technical News* number 7, February 21, 1996.

<sup>47</sup> Paragraphs 69(1)(b) and (c); IT-226R, *supra* note 32, paragraph 8; CRA document number 9641435, May 22, 1997.

<sup>48</sup> *Supra* note 32. Note that the relevant provision for a corporation would be subsection 110.1(3).

the purposes of the application of the administrative position in paragraph 8 of IT-226, where the elected amount is greater than the fair market value of the residual interest donated to the charity, the elected amount will be the proceeds of disposition of the property to the trust for the purposes of calculating the capital gain (or loss) of the settlor, but the donation receipt will reflect the fair market value of the residual interest.<sup>49</sup>

CRA has also indicated that the residual interest is not a “non-qualifying security” within the meaning of the definition in subsection 118.1(18) of the Act<sup>50</sup> and that the rules against “loanbacks” in subsection 118.1(16) would not apply where the residual interest is donated to a non-arm’s length charity.<sup>51</sup> From the perspective of the recipient charity, CRA has indicated that provided the trust is structured to meet the requirements of the previous 10-year gift rules (be subject to a trust or a direction to the effect that the property is to be held by the charity for not less than ten years),<sup>52</sup> it will not be included in the charity’s disbursement quota in the year of receipt.<sup>53</sup>

## **2. Benefits of Making a Gift through a Charitable Remainder Trust**

There are a number of advantages for gifts made through a charitable remainder trust. The first and most obvious benefit is the ability of the donor to immediately claim a donation tax deduction or credit in respect of a deferred gift while continuing to enjoy the property or receive income therefrom. This is particularly attractive for individuals wishing to make a significant donation of property during their lifetime but who still require the use of the property or a guaranteed income stream. If done through a testamentary trust, the settlor can ensure that an income beneficiary is provided for during their lifetime, while at the same time guaranteeing a significant donation to charity and providing the estate with some tax relief.

Assets transferred to a charitable remainder trust during the settlor’s lifetime will not form part of the settlor’s estate and will not be subject to probate fees. Further, since the

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<sup>49</sup> *Supra* note 33.

<sup>50</sup> Question 12, *1998 Conference for Advanced Life Underwriting*, CRA document number 9807000, May 12, 1998; CRA document number 1999-0006945, *supra* note 33.

<sup>51</sup> CRA document number 2001-0087375, *supra* note 42.

<sup>52</sup> Paragraph (b) of “A” of the definition of “disbursement quota” in subsection 149.1(1) of the Act before the enactment of the 2004 budget on March 22, 2004. After March 22, 2004, the gift of the residual interest would have to be considered “enduring property” within the meaning of paragraph (c) of the definition in subsection 149.1(1) and be required to be held for ten (10) years.

<sup>53</sup> CRA document number 9807185, *supra* note 33.

assets pass to the charity under the terms of the trust agreement, the donation will not be considered a testamentary gift and will not be subject to provincial dependant's relief legislation.<sup>54</sup>

### **3. Concerns Regarding Charitable Remainder Trusts**

One of the main concerns regarding charitable remainder trusts is the fact that such structures are mostly established on the basis of CRA administrative policy which remains under review and that there is scant legislative or caselaw support.<sup>55</sup> In addition, the favourable treatment given to charitable gifts of publicly listed shares discussed above does not apply to shares used to fund a charitable remainder trust since the shares are being transferred to the trust and not a charity.

Further, CRA's positions with respect to some of the issues surrounding charitable remainder trusts are not without some controversy and uncertainty exists with respect to some of the tax consequences of such gifts. Some authors disagree with the view that it is the entire property which is disposed of to the trust on the basis that this disregards the theory that the property consists of a bundle of rights and that where the donor retains the right to use the property all that has been disposed of to the trust is the future interest to be granted to the charity.<sup>56</sup> It is unclear whether the settlor's donation limit, which is generally of 75% of the settlor's income in the year, will be increased by the addition of 25% of the taxable capital gain realized on the disposition by virtue of item "B" in the definition of "total gifts" in subsection 118.1(1). The language in the formula applies to the "taxable capital gain ... from a disposition that is the making of a gift made by the individual in the year, which gift is included in the individual's total charitable gifts for the year." With a charitable remainder trust the taxable capital gains arises on the disposition of the property to the trust which while not a gift could arguably be considered part of the "making of a gift."<sup>57</sup> Another question relates to whether capital gains realized within the trust are taxable in the trust, or whether it is

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<sup>54</sup> Susana Lam, "Charitable Remainder Trusts," (2005) 53:2 *Canadian Tax Journal* 506-538 at 509.

<sup>55</sup> The Canadian Association of Gift Planners and other sector organizations continue to negotiate with Finance and CRA, tabling a proposal in the Spring of 2003, but no legislative changes have yet been tabled in the House of Commons. See the recommendations in the recent submission by the CAGP to the Parliamentary Standing Committee on Finance, *supra* note 31.

<sup>56</sup> Blake Bromley, "Creative Planning of Charitable Donations," in *Report of Proceedings of the Forty-Eighth Tax Conference*, cited in Susana Lam, *supra* note 54 at 515.

<sup>57</sup> *Ibid.*

possible to make a designation under subsection 104(21) so that the capital gains are deemed to be the income of the charity and not taxable, or whether section 105 of the Act could apply so that the income could be allocated by the charity to the trust.<sup>58</sup>

Finally, it is not clear that CRA would accept charitable remainder trust structures involving multiple generations or lives. In the context of factual circumstances where the life interest expires upon the death of the last surviving spouse, CRA has indicated that it will not comment on charitable remainder trusts involving structures other than the two dealt with in IT-226R: where the settlor makes an *inter vivos* gift to the trust retaining a single life interest and where the settlor makes a testamentary gift to the trust granting a life interest to a spouse.<sup>59</sup> This suggests that CRA may not approve such structures, presumably on the basis that the property eventually to be received by the charity will be so remote as to have little if any value.

#### **4. Conclusion**

In the present environment of uncertainty with respect to the future direction of policy with respect to charitable remainder trusts, prudent planning opportunities may be limited to the two types of structures contemplated by IT-226R. However, a well-structured charitable remainder trust or series of trusts can be effectively used to maximize the use of the donation tax credit during a donor's life while continuing to permit the donor to use and/or receive income from the property. Because of the availability of the election in subsection 118.1(6) on the transfer of the property, charitable remainder trusts have been effectively used in the past to minimize the potential tax liability in respect publicly listed shares with significant accrued capital gains. While this planning opportunity may not be as attractive with the recent elimination of the tax on capital gains occurring on the outright donation of such shares to a charity, it is still a consideration for other types of shares or capital property with significant accrued gains.<sup>60</sup> Further guidance from CRA and Finance in this area is constantly being called for by the charitable sector. In the meantime, it is necessary for estate planners and solicitors to take into consideration CRA's views when considering the use of a charitable remainder trust to ensure that the structure created will achieve the intended estate and tax planning results.

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<sup>58</sup> *Ibid.* at 516-17.

<sup>59</sup> CRA document number 9807185, *supra* note 33.

<sup>60</sup> See Susana Lam, *supra* note 54 at 517ff for a detailed discussion of various planning opportunities.

## **D. Charitable Donations Made Through Wills**

While the Act provides tax relief to a donor for charitable gifts during his/her lifetime, where gifts are made as a result of the donor's death, the tax relief is even greater. As a result, making charitable gifts through wills is an attractive estate planning tool under certain circumstances. Making charitable gifts through wills may be done in a variety of ways, such as outright legacies and bequests or from the residue of an estate, gifts made from a spousal trust after the intervening life interest of the surviving spouse, etc. The availability of the donation tax credit will depend on the circumstance in each case and the manner in which the will is drafted.

### **1. Benefits of Making Charitable Gifts by Will**

There are a number of advantages for gifts made under one's will pursuant to subsection 118.1(5).<sup>61</sup>

Subsection 118.1(5) deems a gift made by an individual's will to have been made by the individual immediately *before* he/she died. Subsection 118.1(4) provides that a gift made in the year of death is deemed to have been made in the year immediately prior to death to the extent that the tax credit for the gift has not been claimed in the year of death. This would allow the donation tax credit to be claimed in the individual's terminal tax return or in the year immediately prior to death. The credit may also be claimed by the deceased even if the gift is to be made by the deceased's representatives or estate trustees. In addition, tax liabilities arising from the deemed disposition of capital property of the deceased upon death<sup>62</sup> may be offset by donation tax credits arising from such a gift in the terminal return.

When an individual makes a donation to a qualified donee,<sup>63</sup> the individual is permitted to claim a tax credit when calculating the tax payable. Pursuant to subsection 118.1(3), the credit is currently 15.25%<sup>64</sup> of the first \$200 eligible amount of donations<sup>65</sup>

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<sup>61</sup> M. Elena Hoffstein, "Alter Ego Trusts/Joint Partner Trusts – Tips, Traps & Planning" (Paper presented to the 2004 Ontario Tax Conference, Canadian Tax Foundation, 2004) 12A:1-47 at 15.

<sup>62</sup> Subsection 70(5).

<sup>63</sup> *Supra* note 11. See also *infra* note 65.

<sup>64</sup> "Appropriate percentage" is defined in subsection 248(1). The applicable percentage is the lowest percentage set out in paragraph 117(2)(a). Paragraph 117(2)(a) has been amended by the 2006 federal budget, *An Act to implement certain provisions of the budget tabled in Parliament on May 2, 2006*, S. C. 2006, c. 4, enacted on June 22, 2006, so that the tax rate is 15% for 2005, 15.25% for 2006, and 15.5% for 2007 and after.

made in the taxation year, and 29%<sup>66</sup> for eligible amounts of donations made over \$200 in the taxation year. The province of Ontario applies the lowest provincial tax rate to the first \$200 donation and the highest provincial rate to donations over \$200.<sup>67</sup> Unused donation credits in a year may be carried forward for five years if they are not claimed in the year the donations are made.<sup>68</sup> Generally, the maximum amount of donations that may be claimed in a year is 75% of net income.<sup>69</sup> Subsection 118.1(1) provides that the 75% limit does not apply in the year of the donor's death and the immediately preceding year.<sup>70</sup> Therefore, donations made in the year of the donor's death and the immediately preceding year could be deducted up to 100% of the deceased's income in those years.

Where a gift made as a result of a person's death does not satisfy the requirements under subsection 118.1(5), the estate or the testamentary trust, instead of the deceased, may be entitled to a charitable donation credit pursuant to subsection 118.1(3) up to 75% of the income of the estate or trust. In other situations, a gift made from a testamentary trust to a charity may not be treated as a gift, but may be treated as a distribution in satisfaction of the charity's income interest in the trust or as a distribution in satisfaction of the charity's capital interest in the trust.<sup>71</sup>

## **2. Application of Subsection 118.1(5)**

There is little case law dealing with what would constitute a gift made by will pursuant to subsection 118.1(5). The interpretation of this subsection has been, in the most part, in accordance with the positions taken by CRA in its various interpretation bulletins, technical interpretations and rulings. Therefore, it is important for estate planners and solicitors to take

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<sup>65</sup> "Eligible amount" of a gift is defined in proposed subsection 248(31) to be the amount by which the gift exceeds the amount of advantage received in respect of the gift. The proposed definition applies to gifts made after December 20, 2002. This proposed change is included in amendments introduced by the Department of Finance on July 18, 2005 that consolidates and further amends previously proposed amendments released on December 20, 2002, December 5, 2003, and February 27, 2004.

<sup>66</sup> This is the highest marginal federal rate of tax set out in paragraph 117(2)(d).

<sup>67</sup> *Income Tax Act*, R.S.O. 1990, c. I.2, s. 4.0.1(24).

<sup>68</sup> See the opening wording of the definition for "total charitable gifts" in subsection 118.1(1).

<sup>69</sup> See paragraph (iii) in the definition for "total gifts" in subsection 118.1(1).

<sup>70</sup> See paragraph (ii) in the definition for "total gifts" in subsection 118.1(1).

<sup>71</sup> See M. Elena Hoffstein, "Legal Analysis," in "Making donations through a will or trust: Struggling with CRA interpretations," *Step Inside* 4:1 (Fall 2004); and D. Bruce Ball and Brenda R. Dietrich, "Bequests and Estate Planning" in *Personal Tax Planning*, (1999) 47:4 *Canadian Tax Journal* 995-1018.

into consideration CRA's view when drafting wills and conducting estate and tax planning.

Previously, CRA took a restrictive view in interpreting subsection 118.1(5). CRA was generally of the view that in order to qualify as a gift made by one's will, the terms of the will must expressly provide that "a specific property, a specific amount or a specific percentage of the residue of the estate is to be gifted to a qualified donee named in the will, without any discretion by the trustees," so that the qualified donee on reading the will can expect that a specific gift will be made to it.<sup>72</sup> In 2001, CRA's views have relaxed in a number of respects. The balance of this section of the paper reviews CRA's current requirements in this regard.

### **3. Gifts Made by a Testator Without Involving any Trusts**

It is possible for charitable gifts to be made as a result of the donor's death without involving any trusts, including: (1) outright legacies and bequests; (2) gifts made from the residue of an estate where there is no intervening life interest; and (3) gifts over to charities in the event that the beneficiaries under the will predecease or disclaim the gifts. In order for the deceased to take the benefit under subsection 118.1(5), the following requirements must be satisfied, failing which, the estate may be able to claim the donation tax credit under the less favorable provisions in subsection 118.1(3) instead.

#### **a) Intention of testator**

Despite changes in CRA's position in other respects in recent years, CRA continues to take the view that in order to qualify as a gift made by a will under subsection 118.1(5), the terms of the will must be clear that the testator has a clear intention to make a donation to a registered charity.<sup>73</sup>

#### **b) Identity of charities to receive gifts**

CRA was previously of the view that in order to qualify as a gift made by a will pursuant to subsection 118.1(5), the identity of the charity to receive the gift must be expressly set out in the will.<sup>74</sup> This restrictive view has been relaxed in recent years.

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<sup>72</sup> CRA document number 2000-0005187, March 6, 2001. See also CRA document number 9732295, March 20, 1998; CRA document number 9922865, September 15, 1999; CRA document number 9918215, December 1, 1999; and CRA document number 2000-0053185, April 18, 2002.

<sup>73</sup> CRA document number 2000-0053185, April 18, 2002.

<sup>74</sup> For example, CRA document number 9732295, March 20, 1998; CRA document number 9918215, December 1, 2000; CRA document number 9922865, September 15, 1999.

### **i) Discretion of trustees to choose charities**

Prior to 2001, CRA was of the position that where the trustees were allowed to choose from a list of charities to receive gifts from the estate, such gifts would not qualify under subsection 118.1(5).<sup>75</sup> In 2001, CRA changed its view so that subsection 118.1(5) would apply where a will stipulates that “a specific amount is to be gifted to charity and provides a list of charities to which donations should be made but discretion is left to the executor to determine the amount to be given to each named charity,” provided that: (1) the actions taken by the executor are reasonable and in accordance with the terms of the will; and (2) the donation is made to a charity.<sup>76</sup> Where the terms of a will direct the trustees to donate a specific amount to a charity without identifying any charity in the will, and the will allows the trustees to have full discretion to decide which charity would receive the gift, such a gift would qualify under subsection 118.1(5).<sup>77</sup>

### **ii) Gifts to charities established after the death of the testator**

In 2001, CRA accepted that where an individual, by a will, provides for a donation to be made to a private foundation to be established by the individual’s estate, the donation would qualify under subsection 118.1(5) because there is no express requirement in subsection 118.1(5) that the donee be in existence at the time of the individual’s death and, in fact, there is “no mention of a donee in subsection 118.1(5).”<sup>78</sup> It is questionable whether this view of CRA could be applied to charitable organizations or public foundations established after the death of the testator. The reason for this is that the establishment of a private foundation is under the

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<sup>75</sup> For example, in CRA document number 9732295, March 20, 1998, the testator set out a list of charities in a will that would be entitled to receive donations from a spousal trust upon the death of the surviving spouse, set out the maximum dollar value of the donations to be made to the charities, and provided the trustees with a discretion to decide how much of a donation to be made up to the maximum amount set out in the will and which charities from the list to receive donations. CRA was of the view that subsection 118.1(5) did not apply because it was not clear from the will which charity would receive the gift.

<sup>76</sup> CRA document number 2000-0055825, March 8, 2001.

<sup>77</sup> CRA document number 20010090205, April 11, 2002. Previously, CRA was of the view that where no charity was named in the will, gifts made to charities chosen by the trustees would only qualify as gifts made by a will if the will empowered the trustees to make gifts in accordance with an intention letter of the deceased and the trustees would have a corresponding legal obligation under the will to make the gifts. See CRA document number 2000-0014355, May 9, 2000.

<sup>78</sup> CRA document number 2000-0005187, March 6, 2001. See also CRA Information Letter CIL-2001-012, May 14, 2001. In CRA document number 2000-0055825, March 8, 2001, CRA reached a similar position.

direction of the testator or the testator's estate, thereby being in the testator's complete control, whereas the establishment of a charitable organization or public foundation is usually not.

**c) Quantum of gifts**

**i) Specific amount or specific percentage of the residue of an estate**

CRA is generally of the view that in order to qualify as a gift made under a will, the will must expressly set out either: (1) the specific amount of the gift; or (2) the specific percentage of the residue of the estate.<sup>79</sup> CRA requires that the will clearly specify what is to be paid from the estate in determining the amount of any residue. Where the trustees have discretion to decide on the quantum of a gift, the ability of such a gift to qualify under subsection 118.1(5) may be affected. This has arisen in the following situations:

**(1) Discretion of trustees to reduce specific amount listed**

CRA is of the view that where the will provides for specified amounts to be given to a number of specified charities, but the executors are given the power to *reduce the amounts*, as necessary, in the event that there are insufficient funds available to make all charitable bequests after the payment of all fees and expenses in the administration of the estate, the actual amount donated by the estate would qualify as gifts made by the will pursuant to subsection 118.1(5).<sup>80</sup>

**(2) Discretion of trustees to decide within a dollar range**

Where a will provides that a gift is to be made to a charity within a dollar range, CRA is of view that the deceased would be entitled to claim a tax credit under subsection 118.1(5) for the minimum amount of the range, with the estate being entitled to a credit under subsection 118.1(3) for donations made above the minimum amount set out in the will. The reason for this would be that donations above the minimum would be "purely within the discretion of the trustee."<sup>81</sup>

**(3) Use of formula to calculate the residue and trustees' discretions**

Instead of specifying the amount of the gift, the will may provide for the donation of

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<sup>79</sup> See CRA document number 2000-0015105, January 11, 2001, CRA document number 2000-0015215, January 11, 2001.

<sup>80</sup> CRA document number 2000-0014355, May 9, 2000.

<sup>81</sup> CRA document number 9918215, December 1, 1999.

specific percentages of the residue of an estate to a charity. In addition, CRA also accepts the use of a formula to calculate the residue of the estate in order to determine the quantum of the donation, where the will provides that the trustees are to “pay for specific debts and expenses from the estate,” provided that the residue is calculated in a reasonable manner that is consistent with the terms of the will.<sup>82</sup>

The foregoing position would also apply to a situation where the will provides for a formula determining the amount of the residue of the estate, subject to the discretionary action of the trustees with respect to making tax elections under the Act in determining the amount of taxes payable by the deceased’s will.<sup>83</sup> In a case where the executors of a will were directed by the court to make donations from the residue to specific charities “to the extent that such donations will minimize income tax payable,” such donations qualified under subsection 118.1(5).<sup>84</sup>

#### **ii) Quantum of *in specie* gifts**

CRA generally requires that the will must expressly set out the specific amount or a percentage of the residue of the gift. However, in a 2004 technical interpretation, the testator’s will indicated that the surviving spouse had the right to select which pieces of art she wished to have from a collection of artwork owned by the testator, with the remaining pieces to be donated to an art gallery within 36 months after the testator’s death. CRA accepted that the donation of the remaining artwork qualified as gifts made by will because “the executor [did] not have any discretion on whether the painting will be donated.”<sup>85</sup>

#### **d) Timing to complete gifts**

CRA is of the view that, in general, gifts made by a will should be completed within a reasonable period of time after death and that CRA may be requested to adjust the tax return in the event that the gift is made after the assessment of the deceased’s final tax return (subject to

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<sup>82</sup> CRA document number 9922865, September 15, 1999.

<sup>83</sup> CRA document number 9918215, December 1, 1999.

<sup>84</sup> CRA document number 2004-0081021R3, January 19, 2005.

<sup>85</sup> CRA document number 2005-0139611E5, November 25, 2005. See also Arthur B.C. Drache, “Gift by Will Clarified,” *Canadian Not-for-Profit News* 14:3 (March 2006) 23.

the time limitation for reassessments).<sup>86</sup>

**e) Form of property to be donated**

CRA generally requires that the will clearly specify what is to be paid from the estate. However, it is possible for trustees to have discretion to decide the form of property to be donated to satisfy the gift, unless the will specifies otherwise, including the following scenarios: (1) where the terms of the will stipulate that a specific amount is to be gifted to a charity, without stipulating as to the form of the gift; and (2) where the will permits a gift to be made in cash or *in specie* and the executor makes a gift of shares provided that the actions taken by the trustee were reasonable and in accordance with the terms of the will.<sup>87</sup>

**f) Conditions attached to gifts**

In situations where conditions are attached to a gift, CRA has accepted that this does not, in itself, negate the gift as one being made by will.<sup>88</sup>

**4. Gifts Made by a Testator Involving Trusts**

Gifts may also be made under a will involving trusts, including gifts made from a spousal trust after the intervening life interest of the surviving spouse, or gifts made from income and/or capital of a testamentary trust (other than a spousal trust) established under a will (e.g. a sum of money set aside in trust for certain purposes with income and/or capital of the trust being available to be gifted to a charity, or the family cottage held in trust for the use by the children of the testator, with the cottage to be gifted to a charity after the death of the last surviving children).

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<sup>86</sup> CRA document number 2000-0053185, April 18, 2002. See also CRA document number 2000-0005187, March 6, 2001, CRA document number 2000-0055825, March 8, 2001, and CRA's Information Letter CIL-2001-012, May 14, 2001.

<sup>87</sup> CRA document number 2000-0011755, January 11, 2001 and CRA document number 2000-0015105, January 11, 2001.

<sup>88</sup> For example, in CRA document number 2001-0069965, March 19, 2001, an individual entered into a written agreement with a registered charity whereby the individual agreed to direct in his will that his executors make a gift of a specific amount to the charity, and the charity agreed to use the bequest to fund the expansion of one of its buildings. The charity also agreed to rename the building in recognition of the bequest for a specified period. The gift would qualify under subsection 118.1(5), provided that the testator was freely parting with the funds or property, received no benefit in return other than the recognition, and the funds or property could never revert to the donor or any related person.

#### **a) Gift made by will - no encroachment of capital**

In order for a gift made from a testamentary trust to qualify as a gift made by will under subsection 118.1(5), all of the criteria concerning outright gifts mentioned above must be satisfied.<sup>89</sup> For example, this may arise in situations where a testator establishes a spousal trust and provides that upon the death of the spouse, gifts be made from the residue of the trust. In addition to satisfying other requirements for gifts made by will, the trust must not have any power to encroach on the capital of the trust before the gifts are made. The rationale for this position is that where the life tenant or trustee has a right to encroach on the capital of the trust, the size of the residual or equitable interest at the time of the donation cannot reasonably be determined.<sup>90</sup>

However, in a 2002 CRA ruling, it was accepted that gifts made to a foundation from the residue of a trust after the death of the spouse qualified under subsection 118.1(5), even though the trustees were given the power to encroach on the capital of the spousal trust. That ruling was granted on the basis that: (1) the spouse irrevocably disclaimed her interest in the capital of the spousal trust; and (2) the trustees undertook not to exercise their authority to make capital of the trust available for the spouse.<sup>91</sup>

#### **b) Gift by trust**

In situations where a gift made from the capital of a trust does not satisfy as a gift made by will, for example, where the trustees are given the discretion to encroach on capital of the trust,<sup>92</sup> or where the trustees are given the discretion to determine the amount of donations to be made from the trust,<sup>93</sup> the trust, instead of the deceased, may be entitled to claim the donation tax credit pursuant to subsection 118.1(3).

#### **c) Distribution in satisfaction of income and/or capital interest of charity vs. donations**

When a payment is made from the income of a testamentary trust, it is sometimes

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<sup>89</sup> See, for example, CRA document number 9732295, March 20, 1998.

<sup>90</sup> Interpretation Bulletin IT-22R, "Gifts to a charity of a residual interest in real property or an equitable interest in a trust," November 29, 1991 at para. 6. See also *O'Brien v. M.N.R.* (1991), 91 D.T.C. 1349 (TCC), CRA document number 9811782, February 11, 1989, and *supra* note 89.

<sup>91</sup> CRA document number 2002-0117823, May 1, 2002.

<sup>92</sup> CRA document number 9811782, February 11, 1999; and CRA document number 9732295, March 20, 1998.

<sup>93</sup> CRA document number 9732295, March 20, 1998.

permissible for such payment to be recognized as a distribution in satisfaction of the charity's income interest in the trust. This would enable the trust to deduct such a payment under subsection 104(6) when calculating the income of the trust, instead of claiming a donation tax credit for that year under subsection 118.1(3). Paragraph 104(6)(b) provides that a trust may deduct, in computing its income, amounts that have become payable or are paid out of the trust income to its beneficiaries.

The test of when a trust is entitled to treat such a payment as a distribution of income interest as opposed to a charitable donation is not clear. CRA appears to have different administrative positions depending on whether it is dealing with a testamentary trust or an alter ego trust.<sup>94</sup>

With testamentary trusts, trustees are allowed the discretion *to choose* whether to treat a discretionary distribution from the trust to a charitable beneficiary as a gift or a distribution in satisfaction of the charity's income interest.<sup>95</sup> However, payment to the charity as income beneficiary may not be taken against income consisting of taxable capital gains arising from the deemed disposition of the trust's assets on death.<sup>96</sup> CRA further clarified that this administrative position enabling the trustee to choose between an income distribution and a gift applies to testamentary trusts, not alter ego trusts.<sup>97</sup>

This is in contrast to CRA's view expressed in document number 9918215, dated December 1, 1999, that "assuming the terms of the will give the trustees discretionary powers to make donations to charities, in our view, it is a question of fact to be determined based on the specific wording of the will and the intention of the trustees at the time a distribution is made to a charity" whether it is a charitable donation or an income payment to an income beneficiary. However, if the trustee has the right to choose between a gift and an income

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<sup>94</sup> Hoffstein, *supra* note 71.

<sup>95</sup> CRA document number 2000-0056625, April 4, 2001. This document is helpful because it summarized CRA's view expressed in two previous technical interpretations, namely CRA document number 9728765, May 6, 1998, and CRA document number 9918215, December 1, 1999.

<sup>96</sup> CRA document number 9728765, May 6, 1998. In CRA document number 2001-0076753, August 1, 2001, a testamentary trust was established to make income and capital payments to a municipality to complete a project, and the trustees were given the discretion with respect to the timing of the payments. CRA took the view that the payments were not charitable donations, because payments from income were payments to an income beneficiary and payments from capital were payments to a capital beneficiary.

<sup>97</sup> CRA document number 2000-0056625, April 4, 2001.

payment, it is difficult to understand why the intention of the trustees is relevant.

With respect to alter ego trusts, CRA explained that where the trust agreement empowers the trustees to make a gift and the trustees exercise this power, it would be appropriate for subsection 118.1(3) to apply; but where the charity is an income beneficiary and a distribution is made out of the trust's income, subsection 104(6) would be the relevant provision.<sup>98</sup> It would appear that the "salient consideration is whether the trust instrument merely 'empowers' the trustees to distribute property to a charity or if it directs that such distributions be made,"<sup>99</sup> although it is difficult to understand why the intention of the trustees is relevant.

## **5. Conclusion**

To conclude, CRA does not appear to have a systematic policy on the requirements of what would qualify as gifts made by will under subsection 118.1(5). Rather, this has been dealt with by CRA on a case-by-case basis, expressed in various technical interpretations to address specific circumstances that arise from time to time, but lacks in a consistent approach. In addition, it is not clear what the deciding factor is in relation to when a payment from a testamentary trust would be treated: (1) as a gift; (2) as an income payment to an income beneficiary; or (3) as a capital payment to a capital beneficiary. With the lack of case law in this area, guidance in this regard from CRA would be welcomed. In the meantime, it is necessary for estate planners and solicitors to take into consideration CRA's view when drafting wills to ensure that the terms of the will they draft would achieve the intended estate and tax planning results.

### **E. Use of Private Foundations**

The effective use of a private foundation could be a very useful and flexible planned giving tool for an individual. Under the Act, there are three types of registered charities, namely charitable organizations, public foundations and private foundations.<sup>100</sup> Public and private foundations are referred to as "charitable foundations" under the Act.<sup>101</sup> These entities differ in a number of respects, including organizational form, relationship between directors/trustees and their control by major donors, disbursement quota obligations, business

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<sup>98</sup> *Ibid.*

<sup>99</sup> Hoffstein, *supra* note 71.

<sup>100</sup> See their definitions in subsection 149.1(1) of the Act.

<sup>101</sup> See definition for "public foundation" and "private foundation" in subsection 149.1(1) of the Act.

activities, granting activities, borrowing activities, and control of other corporations.<sup>102</sup>

Of the three types of registered charities, a private foundation is more suitable to be used for planned giving mainly because it can be controlled by the donor and the donor's family members. Although the Act imposes restrictions on the relationship between directors/trustees of public foundations and charitable organizations and on the control by major donors over those charities, these restrictions do not apply to private foundations. With the newly proposed amendment to these restrictions by replacing the contribution test with a control test,<sup>103</sup> the ability of the donor to control a private foundation is not affected.

### **1. Advantages of Using Private Foundations**

The effective use of a private foundation can provide many benefits that are not available by using other planned giving vehicles.<sup>104</sup>

One of the most attractive features of using a private foundation for planned giving is that it allows the donor to retain control over the assets donated to the private foundation. The donor, his/her family members and other non-arm's length persons may sit on the board of the private foundation and have a tight control over its assets until they are disbursed. As such, the donor can also retain control over the investment of the donated assets.

The donor may involve other family members in the private foundation. This would allow the donor the opportunity to instil altruistic and philanthropic values in them. The charitable activities of the private foundation may bring public recognition of the donor and his/her family in the community. Allowing the private foundation to receive charitable gifts from other family members would increase the sense of involvement and participation of family members in the private foundation. This effect would be even greater if the private foundation bears the name of the donor or his/her family or the foundation may be named after

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<sup>102</sup> For a summary of the differences, see Theresa L.M. Man and Terrance S. Carter, "A Comparison of the Three Categories of Registered Charities" *Charity Law Bulletin* No. 73, July 21, 2005 (online: [www.charitylaw.ca](http://www.charitylaw.ca)).

<sup>103</sup> *Supra* note 6.

<sup>104</sup> See M. Elena Hoffstein and Robin P. Roddey, "Private Foundations and Community Foundations" (2001) 49(5) *Canadian Tax Journal* 1258 at 1260-2; Malcolm D. Burrows, "Choosing the Right Charitable Structure" in "Guiding the Urge to Give," *Step Inside* (Fall 2005) Vol. 5., No. 1, at 3; Michael J. Fremes, "Strategies for Charitable Giving," 1998 Ontario Tax Conference, (Toronto: Canadian Tax Foundation, 1998), 12:1-39 at 19 and 20; Michael Kray, "Establishing a Private Foundation," *The Advisor* (Canadian Cancer Society: Spring 2006).

someone the donor wishes to commemorate.<sup>105</sup>

The donor would be able to “design” what charitable causes the private foundation would support. The activities that a private foundation is permitted to engage in would be governed by the charitable objects set out in its constating documents. The objects must be exclusively charitable in nature and within the recognized four heads of charitable purposes, namely the relief of poverty, advancement of religion, advancement of education, and other purposes beneficial to the community in a way the law regards as charitable.<sup>106</sup> While it is possible for a private foundation to have very general broad objects to provide funding for charitable causes, it is also possible to tailor the objects of the foundation in accordance with the philanthropic desires of the donor. As long as the objects are within the permitted parameters, it is possible for the donor to be innovative in supporting charitable causes.<sup>107</sup>

In addition, a private foundation may be used to build up an asset base for charitable work. This would allow the foundation to leave a lasting legacy of the family in the community. This could be achieved by the donor making one or more large gifts to the private foundation, or allowing the private foundation to receive gifts from family members or other individuals. It is also possible for the donor to give endowed gifts to the private foundation, and/or the private foundation designating certain funds it holds as an endowed fund, and/or the private foundation making endowed gifts to other charities. An endowment means that the capital of the gift is to be held for a definite period of time or for perpetuity, as directed by the donor.

Another attractive feature of using a private foundation is the ability of the donor to maintain privacy in his/her personal affairs, especially when the property donated to the private foundation is shares of the donor’s business. If the gift were made to an arm’s length public foundation or a charitable organization, it might require the donor to disclose information regarding the donor’s personal financial or business affairs, which the donor may not wish to disclose.

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<sup>105</sup> Hoffstein and Roddey, *supra* note 104 at 1261-2.

<sup>106</sup> *Commissioners for Special Purposes of Income Tax v. Pemsel*, [1891] AC 531 (HL). See also Karen J. Cooper and Terrance S. Carter, “Organizational Implications” in “Guiding the Urge to Give,” *Step Inside* (Fall 2005) Vol. 5, No. 1, at 4.

<sup>107</sup> Goodman, Wolfe D., “Some Issues Relating to the Treatment of Private Foundations Under the Income Tax Act” (2000), vol. 16, no. 2 *The Philanthropist* 100-103 at 100.

The donor can make a donation to a private foundation at such a time that is beneficial for the donor's estate and tax planning needs. Once the property is donated to the private foundation, the donor would be able to take immediate advantage of the donation tax receipt issued by the private foundation, while the donor can take time in deciding how to utilize the donated property to meet the charitable objectives of the private foundation. Without a private foundation, sometimes it might be difficult for the donor to coordinate the timing of his/her estate and tax planning with the donation of property to a charity for a particular charitable cause that is acceptable to the donor.

## **2. Limitations on Using Private Foundations**

While there are many benefits in utilizing a private foundation in charitable giving, there are also limitations on its use so that it might not be a suitable planning tool for everyone in all circumstances. It is therefore important for a donor to review in each situation whether the establishment of a private foundation or the making of a particular gift to the donor's private foundation is suitable under the circumstances.

Once a private foundation is established, there will be additional administrative and financial compliance requirements, such as following the required corporate procedures (e.g. holding board meetings and member meetings); filing the applicable annual and periodic corporate returns in the jurisdiction in which the private foundation is incorporated; filing annual Registered Charities Information Returns (Form T3010) within six (6) months of its fiscal year end;<sup>108</sup> keeping adequate books and records; issuing donation receipts in accordance with the requirements under the Act,<sup>109</sup> etc. However, with motivated individuals and careful compliance, this limitation may not be a significant deterrent factor.<sup>110</sup>

Private foundations are subject to the applicable provincial statutes that apply to charities. In Ontario, private foundations are subject to the oversight of the Ontario Public Guardian and Trustee (as are public foundations and charitable organizations), which has the power to take steps to ensure that directors of private foundations would not be in a conflict of interest or breach of trust, despite their non-arm's length relationship with the foundation.<sup>111</sup>

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<sup>108</sup> Subsection 149.1(41) of the Act.

<sup>109</sup> *Income Tax Regulations* 3501 and 3502.

<sup>110</sup> Burrows, *supra* note 104 at 3.

<sup>111</sup> Hoffstein and Roddey, *supra* note 104 at 1262, and *Re David Feldman Charitable Foundation* (1987), 58 O.R. (2d) 626 (Surr. Ct.).

Other Ontario legislation with which charities must comply includes the *Charities Accounting Act*,<sup>112</sup> the *Charitable Gifts Act*,<sup>113</sup> and the *Trustee Act*.<sup>114</sup>

Under the Act, a private foundation is subject to many restrictions in relation to its operations.<sup>115</sup> For example, no part of the private foundation's income may be payable to, or is otherwise available for, the personal benefit of any of its "proprietor, member, shareholder, trustee or settlor."<sup>116</sup> It cannot carry on any business activities,<sup>117</sup> cannot incur debts other than debts for current operating expenses, the purchase and sale of investments, or the administration of the charitable activities,<sup>118</sup> cannot acquire control of another corporation, except by gift but within limits,<sup>119</sup> and must comply with the disbursement quota requirements under the Act by disbursing at least the required minimum amount of its assets,<sup>120</sup> etc. In operating a private foundation, the donor must be careful to comply with these requirements.

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<sup>112</sup> R.S.O. 1990, c. C.10. The *Charities Accounting Act* allows the Public Guardian and Trustee to request financial information from a charity that directly or indirectly controls a corporation. Regulations under the statute also specify when and how charities may commingle funds received for a restricted or special purpose with other funds similarly received into a single account or investment portfolio. However, under no circumstances may restricted funds be commingled with a charity's general funds.

<sup>113</sup> R.S.O. 1990, c. C.8. The *Charitable Gifts Act* contains limitations on the ability of charities to hold an interest in a business.

<sup>114</sup> R.S.O. 1990, c. T.23. The *Trustee Act* contains a prudent investment standard governing investment decision making of trustees or board of directors of charities, and permits charities to delegate their investment decision making to qualified investment advisers under certain circumstances.

<sup>115</sup> See, for example, Goodman, *supra* note 107; Sian M. Matthews, "Tax Issues" in "Guiding the Urge to Give," *Step Inside* (Fall 2005) Vol. 5, No. 1, at 3 and 4; and Cooper and Carter, *supra* note 106 at 4 and 5.

<sup>116</sup> See definition for "charitable foundation" in subsection 149.1(1) of the Act.

<sup>117</sup> Paragraph 149.1(4)(a) of the Act. However, public foundations and charitable organizations are permitted to do so under paragraph 149.1(3)(a) and under paragraphs 149.1(6)(a) and 149.1(2)(a) respectively.

<sup>118</sup> Paragraph 149.1(3)(d) and 149.1(4)(d) of the Act. CRA's view of the extent to which foundations may incur debts was relaxed recently. See CRA document number 2005-015475117, October 21, 2005 and Theresa L.M. Man, "Foundations Incurring Debts to Purchase Investments," *Charity Law Bulletin* No. 86, February 7, 2006 (online: [www.charitylaw.ca](http://www.charitylaw.ca)).

<sup>119</sup> Paragraphs 149.1(3)(c) and 149.1(4)(c) of the Act.

<sup>120</sup> Subsection 149.1(1) of the Act. Amendments to the disbursement quota rules were introduced by the 2004 federal budget and were enacted on May 13, 2005 as the *Budget Implementation Act, 2004, No. 2.*, R.S.C., 2005, c. 19. See M. Elena Hoffstein and Theresa L.M. Man, "New Disbursement Quota Rules under Bill C-33," paper presented to the Canadian Bar Association/Ontario Bar Association 3rd National Symposium on Charity Law, May 6, 2005 (online: [www.charitylaw.ca](http://www.charitylaw.ca)).

For example, if shares of the donor's corporation were to be donated to the private foundation, care must be taken that the acceptance of those shares by the private foundation would not lead the private foundation to have "acquired control" of the corporation.<sup>121</sup>

The donation of publicly listed securities or ecologically sensitive land to a private foundation would not allow the donor to benefit from the elimination of capital gains tax on such gifts introduced by the 2006 federal budget as explained above in this paper. Therefore, if the donor wishes to take advantage of these benefits, the donor would need to donate these gifts to either a public foundation or a charitable organization.

Donation of "non-qualifying securities" to private foundations is also subject to serious restrictions. A non-qualifying security<sup>122</sup> is generally shares in a company with which the donor does not deal at arm's length or obligations (e.g. debts) owed to the donor by a company with which the donor does not deal at arm's length. These rules also include other non-arm's length transactions, such as transactions with the donor's estate, or any person or partnership with which the individual or the estate does not deal at arm's length. A non-qualifying security does not include a security that is listed on any of the prescribed stock exchanges set out in Regulation 3201 such as the Toronto Stock Exchange. It also does not include "excepted gifts," which is defined to be a share donated to either a public foundation or charitable organization (but *not* a private foundation) with which the donor deals at arm's length, and the donor deals at arm's length with each director/trustee of the recipient charity.

When a donor donates a non-qualifying security to a private foundation, a donation tax receipt will not be issued at the time when the donation is made. However, a receipt may be issued if, within five (5) years of the donation, either the recipient private foundation disposes of the non-qualifying security or the non-qualifying security ceases to be a non-qualifying security (e.g. by the private corporation going public and listed on one of the prescribed stock exchanges). The value of the receipt issued will be the lesser of: (1) the fair market value of the security at the time of the donation; or (2) the fair market value of the security at the time when it ceased to be a non-qualifying security or the fair market value of the consideration received by the private foundation that disposed of the non-qualifying security. For a donor who has

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<sup>121</sup> Generally, control occurs when the foundation owns 50% or more of a corporation's issued share capital, having full voting rights under all circumstances. However, the Act permits an exception where the foundation has not bought more than 5% of these shares and is given a bloc of shares that brings up its total holding to more than 50%, it will not be considered to have acquired control of the corporation.

<sup>122</sup> Subsection 118.13(18) of the Act.

made a gift of non-qualifying security and has realized a gain from the gift, he is permitted to claim a reserve under subsection 40(1.01) during the five (5) year period until the gift is deemed to have been made. This provision allows the inclusion of income to be deferred until the donation tax credit can be claimed. These rules apply to gifts made after July 1997.

Therefore, gifts of private company shares by a donor who controls the company and gifts of debts (such as a promissory note issued to the donor by the donor's company) in respect of a donor's corporation are non-qualifying securities and will be subject to the rules.

Another restriction on private foundations involves rules concerning loan backs and non-qualified investments.<sup>123</sup> A loan back involves two steps. First, a donor makes a regular gift to a charity and receiving a donation receipt. Second, within five (5) years after having made the gift, the recipient charity either: (1) acquires a non-qualifying security from the donor; or (2) the charity allows the donor (or a non-arm's length person to the donor) who is not at arm's length to the charity to use the donated property. When either of the two situations in the second step arises, the value of the gift made by the donor shall be reduced by either the amount paid by the charity to acquire the non-qualifying security or the fair market value of the property used by the donor or a non-arm's length person to the donor. The Act also provides for a first-in first-out ordering rule to deal with the order of the reduction in tax credits when the above-note rule applies. These rules apply to gifts made after July 1997 and the donor's use of the charity's property after July 1997.

A donor would need to be careful not to inadvertently violate the loan back provisions. For example, a donor agreeing to keep a painting in his/her house for a period of time after having donated the painting to a private foundation may trigger the loan back provision.<sup>124</sup> Another example would involve a donor making \$1000 donation to a private foundation and the foundation later lending \$500 to the donor's company, or the private foundation later purchasing shares in the donor's company using all or part of the \$1000 donation.

Further, private foundations holding non-qualified investments will be subject to a penalty tax if the interest payable to the foundation does not meet a minimum rate of return.<sup>125</sup> A non-qualified investment includes a debt, share or right to acquire a share held by a private

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<sup>123</sup> Subsection 118.1(13) and (14) of the Act. These sections were enacted as a result of the decision of *Jabs Construction Limited v. The Queen*, 99 DTC 729 (TCC).

<sup>124</sup> Hoffstein and Roddey, *supra* note 104 at 1268.

<sup>125</sup> Section 189 of the Act.

foundation that is issued by a person not dealing at arm's length with that foundation, but does not include shares on a prescribed stock exchange. For example, a private foundation making a loan to a non-arm's length person and not charging enough interest would trigger the penalty tax.

### **3. Factors to Consider When Establishing a Private Foundation**

Before establishing a private foundation, the donor should be familiar with the various benefits and limitations of using a private foundation to ensure that the establishment of a private foundation would be beneficial and suitable in the donor's circumstances. The following are some other issues that would need to be addressed by the donor when establishing a private foundation.<sup>126</sup>

Is there any charity that the donor would feel comfortable donating to that would meet the donor's philanthropic desires and achieve the donor's tax and estate planning? If so, then the donor may consider making such a gift without the need to go through the time and effort of establishing his/her private foundation.

What would be the charitable objects of the private foundation and what types of charitable causes would the foundation support?

What should be the legal form of the private foundation? A private foundation must be organized as a corporation or a trust, rather than as an unincorporated association.<sup>127</sup> In general, the corporate form is preferred in order to reduce the exposure of the directors and members of the foundation to personal liability,<sup>128</sup> although this might not be very effective with respect to the donor who controls the private foundation.

Under what jurisdiction should the foundation be incorporated? In Ontario, there is a choice of incorporating under Part III of the *Corporations Act* (Ontario)<sup>129</sup> or Part II of the federal *Canada Corporations Act*<sup>130</sup> as a non-share capital corporation. Incorporation under the federal statute would better facilitate the foundation to have operations across Canada in

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<sup>126</sup> See Philanthropic Foundations Canada, *Starting a Foundation: A Guide for Philanthropists* (Montreal: Philanthropic Foundations Canada, 2004).

<sup>127</sup> See the definition for "charitable foundation" in paragraph 149.1(1) of the Act.

<sup>128</sup> Cooper and Carter, *supra* note 106 at 5.

<sup>129</sup> R.S.O. 1990, c. C.38.

<sup>130</sup> R.S.C. 1970, c. C-32.

all provinces. A new *Canada Not-for-profit Corporations Act* was proposed in 2004 to replace Parts II and III of the federal *Canada Corporations Act*. The final form of the proposed statute has not been released and the status of the proposal is unclear at this time.

How should the foundation be structured? Who would be on the board and how would the donor exercise control in the foundation? Does the donor have other trusted family members who can sit on the board?

Will the foundation receive funds from the donor, family members or other individuals? Will the foundation hold endowed funds or grant endowed gifts? Will the foundation be a passive funder or will the foundation carry on active charitable programs? Although public foundations must give more than 50% of their income annually to other qualified donees while charitable organization may grant up to 50% of its income annually to other qualified donees, these requirements do not apply to private foundations.