
CBA/OBA 2008 NATIONAL CHARITY LAW SYMPOSIUM

NEW THOUGHTS ON GIFTING

Toronto - May 7, 2008

**GIFTS OF ENVIRONMENTALLY
SENSITIVE LAND: WHAT YOU NEED TO
KNOW AND HOW TO USE THEM**

By Karen J. Cooper, LL.B., LL.L., TEP

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Gifts of Environmentally Sensitive Land: What You Need to Know and How to Use Them

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A. INTRODUCTION

Private lands are becoming increasingly important to the protection of Canada's environmental heritage and biodiversity. As an incentive for landowners to help protect the environment, the *Income Tax Act* ("ITA") provides favourable income-tax treatment for gifts of ecologically sensitive land and partial interests in land through the Ecological Gifts Program ("EGP").

The EGP was introduced in 1995 as a tool for encouraging the conservation of habitat and biodiversity across Canada. The Program is administered by Environment Canada and promotes the donation of privately held land or certain interests in land certified as ecologically sensitive to municipalities, federal and provincial Crown agencies or approved conservation charities. The EGP enables individual and corporate landowners to protect their ecologically-sensitive land forever by donating the land, or conservation easements, covenants or servitudes on land, to eligible recipients and receiving enhanced income tax benefits in return. These tax benefits include the provision of tax credits or deductions and the elimination of the taxable capital gain realized on the disposition of the property. As of March 2008, 652 ecological gifts totalling 112,199 hectares and valued at over \$379 million have been made in Canada.¹ Nearly half of these gifts contain habitats designated as having national, provincial, or regional importance, and many include rare or threatened habitats that are home to species at risk.²

¹ Personal communication on April 29, 2008 with National Secretariat of the Ecological Gifts Program.

² Environment Canada, *Ecological Gifts Program: A legacy for tomorrow...a tax break today* (available at <http://www.cws-scf.ec.gc.ca/egp-pde/>).

B. BASIC REQUIREMENTS OF AN ECOLOGICAL GIFT

An ecological gift is a particular type of charitable gift under the ITA and a number of specific requirements are associated with ecological gifts. The ITA defines an ecological gift as

the fair market value of a gift ... of land, including a servitude for the use and benefit of a dominant land, a covenant or an easement, the fair market value of which is certified by the Minister of the Environment and that is certified by that Minister, or a person designated by that Minister, to be ecologically sensitive land, the conservation and protection of which is, in the opinion of that Minister, or that person, important to the preservation of Canada's environmental heritage, which gift was made by the individual in the year or in any of the five immediately preceding taxation years to

(a) Her Majesty in right of Canada or a province or a municipality in Canada, or

(b) a registered charity one of the main purposes of which is, in the opinion of the Minister of the Environment, the conservation and protection of Canada's environmental heritage, and that is approved by that Minister, or that person, in respect of that gift.³

Therefore, for donors to receive the tax benefits of an ecological gift, the ITA requires that the Minister of the Environment, through Environment Canada, or a designated authority certify the following:

1. Eligible Recipient: The recipient must be 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;⁴
2. Ecologically Sensitive Land: the land, including a servitude, covenant or easement, must be ecologically sensitive and its conservation and protection important to the preservation of Canada's environmental heritage; and
3. Fair Market Value: The fair market value of the gift must also be certified.

³ *Income Tax Act*, ss. 110.1(1)(d) and 118.1(1), definition of "total ecological gifts". This is the definition of "ecological gift" in force at the time of writing. It does not reflect the proposed amendments related to split-receipting and harmonization with civil law in Bill C-10, *Income Tax Amendments Act, 2006*, subsection 102(6) (Senate second reading — December 4, 2007 and referred to the Senate Committee on Banking, Trade and Commerce).

⁴ A list of 172 registered charities currently approved by the Minister of the Environment to receive ecological gifts is available at the Environment Canada website at <http://www.cws-scf.ec.gc.ca/egp-pde/default.asp?lang=en&n=BEBC00B5>.

Once a donor has identified the land subject to the gift and a qualified recipient, information regarding the ecological sensitivity of the land must be filed with Environment Canada. Environment Canada has developed a definition of “ecologically sensitive land,” which is based on national, provincial or territorial criteria that are outlined in *The Canadian Ecological Gifts Program Handbook 2005* and updated on the Environment Canada website.⁵ Existing environmental values of the land and those that may result from conservation initiatives are included in the consideration of what is ecologically sensitive. The Minister has designated a number of federal and provincial government officials as certification authorities who are able to certify the ecological sensitivity of land to be gifted under this program. In addition, in limited situations it is possible for non-government national and provincial conservation organizations to be designated by the Minister as certification authorities for ecological gifts to their own organizations. Once the ecological sensitivity of the land has been established, the Minister of the Environment, or his designate, will issue a *Certificate for Donation of Ecologically Sensitive Land* (or, in Quebec, a *Visa pour dons de terrains ou de servitudes ayant une valeur écologique*).

After the property is determined to be ecologically sensitive, the donor must apply for certification of the value of the donation. While the ITA provides little specific guidance on the determination of the fair market value of ecological gifts, it does specify that the value of an ecological gift of an easement, covenant or servitude to which land is subject may be determined using the “before and after” method of valuation, e.g. the fair market value of the gift is the value of the land before the grant of the easement, covenant or servitude minus the fair market value of the land after the grant.⁶

In order obtain certification of the fair market value of an ecological gift, the donor must submit an independent appraisal of the fair market value of the donation⁷ to Environment Canada, along with a signed application form.⁸ The appraisal is reviewed by an independent body, the Appraisal Review Panel, which makes a recommendation of fair market value to the Minister of the Environment. The Minister then determines the fair market value, taking into account the recommendation of the Appraisal Review Panel.⁹ The donor may either accept the determination of fair market value or seek a redetermination by

⁵ Available through the Environment Canada website at <http://www.cws-scf.ec.gc.ca/egp-pde/default.asp?lang=en&n=6E9B56B5>. See also <http://www.cws-scf.ec.gc.ca/egp-pde/default.asp?lang=En&n=C6232D19-1>.

⁶ *Income Tax Act*, ss. 118.1(12) and 110.1(5).

⁷ Environment Canada has issued detailed guidelines for appraisals and a format that should be adhered to when submitting appraisals in relation to ecological gifts. See <http://www.cws-scf.ec.gc.ca/egp-pde/default.asp?lang=En&n=2E498C05-1>.

⁸ *Income Tax Act*, s. 118.1(10.2).

⁹ *Ibid.*, s. 118.1(10.3).

the Redetermination Committee of the Appraisal Review Panel. The Minister then either confirms the value previously determined or redetermines the value, taking into account the recommendation of the Redetermination Committee.¹⁰ If the donor still does not agree with the Minister's determination or redetermination, an appeal of the Minister's decision may be brought to the Tax Court of Canada within 90 days.¹¹

If the donor agrees with the fair market value that Environment Canada is prepared to certify, the donation can then be completed (i.e. the title to the land can be transferred or the conservation easement, covenant or servitude registered). Once the ecological gift has been made, the Minister issues a *Statement of Fair Market Value of an Ecological Gift* ("Statement") certifying its fair market value as established on the determination or redetermination, as the case may be.¹² Once the Statement has been issued, the recipient charity will issue an official donation tax receipt.

C. TAX BENEFITS

The tax benefits related to the donation of ecological gifts are more significant than those attributable to ordinary gifts, including the removal of the upper donation limit and the elimination of the taxable capital gain realized on the disposition of the property. Further, proposed amendments to the ITA allowing for split-receipting in respect of donations to registered charities will greatly facilitate the donation of ecologically sensitive land by providing even more flexibility to donors. To benefit from the enhanced tax benefits of an ecological gift, donors must include the following in their income-tax returns: a *Certificate for Donation of Ecologically Sensitive Land* (or *Visa* in Quebec); a Statement with respect to the fair market value of the gift; and an official receipt for income tax purposes from the recipient.

Corporate donors may deduct the amount of their ecological gift directly from their taxable income,¹³ while the value of an individual's ecological gift is converted to a non-refundable tax credit.¹⁴ The tax

¹⁰ *Ibid.*, s. 118.1(10.4).

¹¹ *Ibid.*, s. 169(1.1). It is important to note that it is only an appeal of the certificate issued pursuant to subsection 118.1(10.5) which may be filed. This means that the gift must be completed and the certificate issued before an appeal can be brought of a determination or redetermination of the fair market value of the gift pursuant to subsection 118.1(10.4). Quite often donors will seek a determination and/or redetermination of fair market value before completing a gift in order to fully ascertain the tax consequences of a gift. The language in subsection 169(1.1), however, limits the right of appeal to only those situations where the gift has actually been completed.

¹² *Ibid.*, s. 118.1(10.5).

¹³ *Ibid.*, s. 110.1(1).

¹⁴ *Ibid.*, s. 118.1(3).

credit is calculated by applying a rate of 15 per cent to the first \$200 of the donor's total gifts for the year and 29 per cent to the balance.¹⁵ Unlike other charitable gifts, there is no limit to the total value of ecological gift donations eligible for the deduction or credit in a given year. However, similar to other charitable gifts, any unused portion of the donor's ecological gifts may be carried forward for up to five years. If the taxpayer is unable to use the full amount of the tax credit or deduction within five years, the unused portion is lost.

In the 2006 Federal Budget released on May 2, 2006,¹⁶ and subsequent amendments to the ITA, the government removed the capital gains tax on listed securities donated to charities and extended this measure to gifts of ecologically sensitive land, effective for gifts made subsequent to the date of the Budget. Donors who dispose of capital property, such as land, will usually realize a capital gain—a portion of which is taxable—where the deemed proceeds of disposition exceed the property's adjusted cost base (usually the original purchase price of the land).¹⁷ For most gifts of capital property, the taxable portion is 50 per cent of the capital gain, but for ecological gifts paragraph 38(a.2) of the ITA provides that the taxable capital gain will be equal to zero. Also similar to donations of publicly-listed securities, corporate donors will benefit from the inclusion of the entire amount of the capital gain in the donating corporation's capital dividend account.¹⁸

Gifts of land held on account of inventory that meet the requirements of the EGP will also qualify as ecological gifts. However, the elimination of any taxable capital gain and the inclusion of the capital gain in the capital dividend are benefits that do not apply to gifts of inventory land and the proceeds of disposition deemed to arise from the gift as a result of the application of subparagraph 69(1)(b)(ii) will be included in taxable income, although it will likely be offset by a corresponding deduction or tax credit.

Proposed amendments to the ITA will ensure that the definition of "ecological gift" corresponds to changes resulting from the introduction of split-receipting.¹⁹ As a result of the proposed amendments, the definition of "total ecological gifts" will refer to the "total of all amounts each of which is the eligible amount of a gift of land" which, in turn, will cause proposed new subsections 248(30) to (33) to apply to

¹⁵ *Ibid.*, s. 117(2) for 2007.

¹⁶ See <http://www.fin.gc.ca/budget06/bp/bpc3ce.htm#donations> for the relevant section of the Budget 2006 documents.

¹⁷ Note that *Income Tax Act*, subparagraph 39(1)(a)(i.1) provides that there is no capital gain in respect of gifts of cultural property.

¹⁸ Subparagraph (a)(i) of the definition of "capital dividend account" in *Income Tax Act*, s. 89(1).

¹⁹ *Supra*, note 3.

ecological gifts. As a result, the eligible amount of an ecological gift will be the fair market value of the property donated minus any advantage received by the donor or others in return for the gift.²⁰ As with other charitable gifts, it is only the eligible amount of a gift (the fair market value of the property transferred minus the value of any advantage received by the donor) that will give rise to a tax credit or deduction. It is important to note, however, that the proposed amendments relating to the imposition of a deemed fair market value in certain transactions, which are part of the same package of amendments as the split-receipting rules, do not apply to ecological gifts.²¹

D. DISPOSITION OR CHANGE OF USE WITHOUT AUTHORIZATION

Another significant provision of the ITA relating to ecological gifts imposes a special tax on organizations or registered charities that receive ecological gifts and then dispose of them or change their use without the authorization of the Minister of the Environment or the Minister's designate.²² This tax would be imposed, for example, if land or a conservation easement, covenant or servitude were transferred from the recipient to another organization without prior authorization. The amount of the tax is 50% of the fair market value of the property at the time of the unauthorized disposition or change in use. The tax is intended to help ensure protection of ecologically sensitive land for the long term and to deter municipalities and registered charities from disposing of or changing the use of an ecological gift without approval. Currently, no such tax is imposed in relation to ecological gifts and related tax benefits administered under the provisions of the Quebec *Taxation Act*.²³

E. OTHER ISSUES

1. Gifts of Partial Interests

The definition of ecological gifts provides for gifts “of land, including a servitude for the use and benefit of a dominant land, a covenant or an easement.”²⁴ Although many ecological gifts are outright donations

²⁰ Please note in this regard that neither the Appraisal Review Panel nor Environment Canada provides an opinion on the value of any advantage received by the donor or others. This is the responsibility of the recipient organization and why a separate official donation receipt is required. In a recent ruling (Document #2007-024709), CRA considered whether a contractual commitment to donate the land in circumstances where authorization was obtained (presumably for either development or subdivision of adjacent land – the facts have been redacted) would not result in an amount of an advantage within the meaning of proposed subsection 248(32).

²¹ *Supra*, note 3, ss. 248(35), (36), (37), and (39).

²² *Income Tax Act*, s. 207.31.

²³ *Taxation Act*, R.S.Q., c. I-3.

²⁴ *Supra*, note 3. The new language resulting from harmonization amendments will be: “gift ... of land (including a covenant or an easement to which land is subject or, in the case of land in the Province of Quebec, a real servitude).”

of land with no conditions attached, approximately half of all ecological gifts to date have been "partial interests in land" such as conservation easements, covenants or servitudes.²⁵ Quite often gifts of partial interests in land are made because the landowner wants to retain the right to use the land or to ensure that others will continue to be able to live on the land. Generally, gifts of partial interests in ecologically sensitive land will qualify as an ecological gift if the land is made subject to a legal agreement (usually in the form of a covenant, easement or servitude) in favour of an eligible recipient that protects the property's conservation value by permanently placing terms and conditions on its use. For example, the agreement may prevent the land from being subdivided into smaller lots, protect trees from being cut, or prevent the construction of any new buildings. However, the agreement must ensure that the restrictions put on the property are followed in perpetuity, regardless of who owns the underlying land. Various provincial statutes provide for the creation of conservation interests in land, for example the *Manitoba Conservation Agreements Act* and in Quebec the *Loi sur les reserves naturelles en milieu privé*, but care must be taken in these instances to ensure that the interest created meets all of the criteria required of a gift.²⁶

With respect to the fair market value of a gift of a partial interest, the determination of the fair market value of the gift will be based upon the difference between the value of the land before the imposition of the restrictions and the value of the land after the imposition of the restrictions. It would also be possible to gift a residual interest in land, such as a gift of land subject to a life interest in favour of the donor or a particular member of the family. In such instances, the rules discussed in *IT-226R: Gift to a charity of a residual interest in real property or an equitable interest in a trust* would also apply with respect to the determination of the fair market value of the gifted property.

2. Gifts by U.S. residents

United States residents travel, work, and often own property across the ecologically invisible boundary between Canada and the U.S., and U.S. residents owning land in Canada quite often want to ensure that the natural features of their property remain protected into the future. U.S. residents who donate Canadian land to a U.S. 501(c)(3) land trust may qualify for a U.S. income tax deduction under the U.S. Internal Revenue Code. However, the disposition may trigger tax in Canada since the resulting taxable

²⁵ *Supra*, note 5. See also *The Ecological Gifts Program: Retaining the Right to Use Land Donated as an Ecological Gift* available at <http://www.cws-scf.ec.gc.ca/egp-pde/default.asp?lang=En&n=0267F2D5-1&offset=1&toc=show>.

²⁶ See CRA Technical Interpretation, Document # 2002-01634 regarding the Manitoba legislation and Document # 2004-006383 regarding New Brunswick's legislation.

capital gain (the gift not being made to an eligible recipient would not qualify as an ecological gift and benefit from the elimination of the taxable capital gain) would be included in the calculation of the non-resident's taxable income earned in Canada pursuant to subparagraph 115(1)(a)(iii). Subsections 110.1(3) and 118.1(6) of the ITA allow a donor to designate proceeds of disposition in respect of a gift that are between the adjusted cost base of the property immediately before the gift and the fair market value of the gift in order to avoid triggering a taxable capital gain. These provisions would not usually apply to a gift to a U.S. charity since such organizations are not considered qualified donees. However, these provisions will apply to a gift made to a "prescribed donee" who provides an undertaking that the property will be held for use in the public interest. Currently, the Nature Conservancy, a U.S. 501(c)(3), is a prescribed donee pursuant to section 304 of the *Income Tax Regulations*, and we understand that a second, American Friends of Canadian Land Trusts, has applied for similar recognition.

Otherwise, U.S. residents with income from Canadian sources (e.g. employment, land rentals, sales, etc.) can donate Canadian land to a Canadian charity and receive a Canadian tax credit or deduction. However, this credit or deduction will only be usable against the Canadian income tax payable on the donor's Canadian source income.

F. EXAMPLES²⁷

The following are examples involving donations by individuals rather than corporations and do not take into account provincial income tax implications. It is assumed that the gift in each scenario qualifies as an ecological gift and that there are no other inclusions in, or deductions from, taxable income for the donors other than those inclusions and deductions indicated in the example. The unadjusted federal personal income tax rates applicable in 2007 are applied to determine the tax credit and a 46% marginal tax rate is used to determine the tax otherwise payable in each example.

Generally, the amount of the donation claimed in respect of the non-refundable donation tax credit would be determined after taking into account the non-refundable tax credits that the taxpayer is entitled to claim that are not eligible to be carried forward. In all cases, it has been assumed that the landowner is applying as much of the value of the donation as possible to generate tax credits during the year of the donation. The amount available for carry forward has been calculated based on this assumption, even though the

²⁷ These examples are based on examples provided in *Ecological Gifts Program: Donation and Income Tax Scenarios* (Environment Canada, 2007) available at <http://www.cws-scf.ec.gc.ca/egp-pde/default.asp?lang=en&n=F2563E77-1>.

donor has the option of using less than the maximum amount in the year of the gift, if he or she wishes. In addition, it is assumed in every scenario that the adjusted cost base (“ACB”) of the property is its acquisition cost. In reality, there may be a number of factors other than acquisition cost that affect a person’s ACB for tax purposes.

The tax implications of any transaction, including making an ecological gift, depend on the circumstances of the transaction as a whole and on the taxpayer’s individual circumstances. The tax implications of making an ecological gift, therefore, cannot be considered in isolation.

1. Island Property – Outright Donation

Susan is the owner and operator of a small consulting firm in Kingston and earns \$80,000 a year. Thirty years ago she purchased an undeveloped two hectare property on an island in the Thousand Islands for \$200,000. The property, which has water frontage and magnificent views of the St. Lawrence and the Islands, has a FMV of \$600,000 today. Although not particularly large, the island is home to a number of important species of birds, pitch pine and beach fern. Susan has decided not to build her retirement home on the island because she feels it would be too remote for an older woman living alone. However, she would like to ensure that these and other natural features on the property will be permanently protected. Impressed by the efforts of the Canadian Thousand Islands Heritage Conservancy in working with local landowners to link fragmented shorelines and island habitats, Susan decides to donate her land to the Conservancy as an ecological gift.

Environment Canada has certified that the land meets its criteria regarding ecological sensitivity and that the FMV is \$600,000:

Capital gain	\$400,000	(\$600,000 - \$200,000)
Taxable capital gain	\$0	
Self-employment income	<u>\$80,000</u>	
Taxable income	\$80,000	
Income tax payable	\$36,800	(Calculated using 2007 rates)
Claim eligible amount	\$126,990	(\$473,010 remains for future use)
Donation tax credit	<u>\$36,800</u>	
Net tax payable	\$0	

Because the donation is an ecological gift, Susan is not limited to being able to use only 75% of the gift to reduce her income tax payable in the year of the gift. She may use the entire eligible amount of the gift, \$600,000. Also, no taxable capital gain is triggered by the donation. She only needs to claim \$126,990 of the gift, which will result in a non-refundable donation tax credit of \$36,800, eliminating her income tax payable and leaving her with \$473,010 to claim in subsequent years.

2. Mountainside Property - Donation with Split-Receipting

Tim owns a 20 hectare forested mountainside property in the Eastern Townships, near the Vermont border. When he inherited the land from his grandmother Gwyneth 20 years ago, it was valued at \$40,000. Today, it is worth triple that amount (\$120,000). Tim earns \$60,000 a year as a college instructor. While she was alive, Gwyneth was extremely active in the Magog Naturalists Club, and encouraged the use of her land for many wildlife surveys and recreational activities. Tim is too busy to spend much time managing the property or taking part in the naturalist club's efforts. He also has a number of large, unexpected expenses which he has difficulty meeting on his salary. However, he would like to ensure that Gwyneth's legacy is cared for in the same spirit and with the same conservation goals as it was by his grandmother. He decides to take advantage of the new split-receipting rules and transfer the property to a local conservation organization for an amount below its appraised FMV. He will transfer the property as an ecological gift to be maintained in its natural state, with the stipulation that local naturalists, hikers and cross-country

skiers continue to be allowed access to it for recreational purposes. The conservation organization has agreed to pay \$70,000 for the property.

Environment Canada has certified that the land meets its criteria regarding ecological sensitivity and that the FMV of the property is \$120,000. Under the new split-receipting rules, a donor may receive a tax credit for a gift in circumstances where the donor has received some advantage in return. The eligible amount of the gift indicated on the donation receipt in those circumstances would be the amount by which the value of the property transferred to the recipient exceeds the amount of the advantage provided to the donor.

FMV of the property	\$120,000
Amount of advantage	<u>\$70,000</u>
Eligible amount of gift	\$50,000

The capital gain must be allocated between the eligible amount of the gift and the amount of the advantage. As the eligible amount of the gift represents 42% of the value of the property transferred (\$120,000), 42% of the capital gain (\$33,600) is allocated to it. The taxable capital gain in respect of the eligible amount of the gift will be zero. The remaining 58% of the capital gain (\$46,400) is allocated to the advantage. The taxable capital gain in respect of the advantage is 50% of \$46,400 (\$23,200).

Capital gain	\$80,000	(\$120,000 - \$40,000)
Taxable capital gain	\$23,200	
Employment income	<u>\$60,000</u>	
Taxable income	\$83,200	
Income tax payable	\$38,272	
Claim eligible amount	\$50,000	
Donation tax credit	<u>\$14,473</u>	
Tax payable	\$23,799	

G. CONCLUSION

The income tax benefits of making an ecological gift vary greatly depending on the financial situation of each donor, but are as significant as those for donations of publicly listed securities. The ITA requirements and tax implications of making an ecological gift are becoming more complex and care should be taken to ensure that all legal and tax implications of the gift are clearly understood. However, individual and corporate landowners interested in protecting nature by donating ecologically-sensitive land, or interests in that land, to an environmental charity will, in return, receive enhanced income tax benefits in addition to the satisfaction of knowing that they have made a real contribution to greening their environment.