ASSOCIATION OF FUNDRAISING PROFESSIONALS
GREATER TORONTO CHAPTER – CONGRESS 2009

The Legal Track: Keeping Fundraisers in the Know

Toronto – November 30, 2009

Maximizing a Charitable Gift

By M. Elena Hoffstein – Fasken Martineau DuMoulin LLP
And Terrance S. Carter – Carters Professional Corporation

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AGENDA

1. **Charitable Donations Through Wills**
2. **Life Insurance**
3. **Private Company Shares**
4. **Effective Giving Using Holding Company**
5. **Flow-through Shares**
6. **Limited Partnership Interests**
7. **Interest in a Hedge Fund**

1. CHARITABLE DONATIONS THROUGH WILLS

- **100% limit in year of death and prior year**
- **Making charitable gifts through wills is attractive estate planning tool**

*This portion of the presentation is based on the following: (a) paper by Theresa Man and Karen Cooper, Planned Giving for High Net Worth Clients, 2006 Ontario Tax Conference, Oct. 16, 2006; (b) Kathy Munro and M. E. Hoffstein, Making Donations Through a Will or Trust; Struggling with CRA Interpretations, Step Inside 4:1 (Fall 2004); (c) M. E. Hoffstein, Alter Ego Trusts/ Joint Partner Trusts – 2004 Canadian Tax Foundation.

Why are rules relating to gifts by will relevant to charities?

- **Having an understanding of the rules will assist the charity to know when to issue a receipt and when not to**
- **Gifts by will or by estate/trust are entitled to receive receipts from the charity**
- **No receipts if there is an intervening life interest until the death of the life tenant**
- **Distributions to charities in satisfaction of interest in trust (as a beneficiary) income or capital are not entitled to receipts**

- **Disbursement Quota**
  - **Gifts by will or by estate/trust**
    - **Are entitled to receive receipts**
    - **Gifts received by charities by way of bequest or inheritance are enduring property**
    - **Allows charities to hold certain property without the need to expend 80% of it in the following year after receipt**

- **Gifts of enduring property do not affect the DQ of the recipient charity until they are either expended or transferred to another charity, at which time, the expenditure or transfer is added to the DQ calculation for that year**
- **Distribution to charities in satisfaction of interest in trust (as a beneficiary) income or capital are not entitled to receipts, therefore not included in the DQ calculation**

Why are rules relating to gifts by will relevant to donor/taxpayer?

- **Important to understand when charity tax credit is available to which taxpayer – deceased or estate - as this will affect ability to reduce tax or death or during term of the trust or on death of a life tenant**
- **Ensure that tax credit is available when it can best be utilized**

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Forms of Gifts by Will

- **Cash gift to charity**
- **Gift of asset (e.g. art) to charity**
- **Shares of opco to be held in spousal trust**
- **Other assets in family trust with discretionary beneficiaries including charities**
- **On death of spouse charities are residual beneficiaries**

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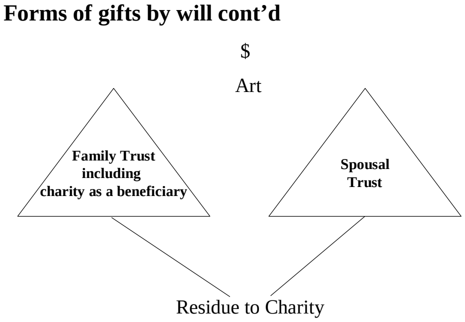
Forms of gifts by will cont'd



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Gifts by Will

- **Subsection 118.1(5) provides that when an individual makes a gift in his/her will, the gift is deemed to have been made by the individual immediately before death**
- **Can also carry back to year prior to death**
- **This allows donation tax credit to be claimed in the terminal tax return of the deceased individual or in the preceding year**

Gifts Not Qualifying as Gifts by Will

- **If gift does not qualify as a "gift by will" it could qualify as a gift by the estate or trust**
- **In such a case, estate or testamentary trust may be entitled to a charity tax credit up to 75% of the income of the estate/trust**
- **In other cases, charity may be beneficiary of a trust such that the distribution to the charity is in satisfaction of an income or capital interest in a trust**

Questions to be Asked

- **Is it gift by will – charity tax credit available in year of death**
- **Is it gift by estate/trust – charity tax credit available to estate/trust**
- **Is it distribution in satisfaction of income or capital interest in a trust**
- **Is it possible to draft will so as to achieve the desired result?**

Testamentary Gifts to Charity

- **Outright gifts**
- **Gifts involving trusts**

Form of Outright Gifts

- **$ or assets (art)**
- **Share of residue of an estate - no intervening life interest**
- **If a beneficiary predeceases and charity is alternate beneficiary**

Trustees Permitted Discretion in Selection of Charities But Not re Quantum

- **Specific amount or specific percentage of residue must be stipulated (i.e. no discounting on quantum)**
- **Will can stipulate that a specific amount be gifted to charity and provide a list of charities to which donations be made with the trustees having a discretion to determine the amount to be given to each named charity, or trustees can have full discretion to decide which charity gets gifts**

CRA Docs #9732295 (Mar 20/98); #9918215 (Dec 1/00); #9922865 (Sept 15/99); #2000-0055825 (Mar 8/01)

Gifts to Charities Established After the Death of the Testator

- **CRA has accepted a gift by will where will directs a private foundation to be established following the testator's death**
- **Query whether this view could be applied to charitable organizations or public foundations established after the death of the testator**

CRA Doc # 2000-0005187 (Mar 6/01); See also CRA Information Letter O/L 2001-012 (Mary 14/01); and CRA Doc# 2000-005825 (Mar 8/01)

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Form of Property to be Donated

- **Will must specify what is to be paid from the estate**
- **Trustees can have discretion to decide the form of property to be donated, unless the will specifies otherwise**
- **e.g.**
  - **The will stipulates that a specific amount to be gifted to a charity, without stipulating the form of the gift**
  - **The will permits a gift to be made in cash or *in specie***
- **Conditions attached to gifts are acceptable**

CRA Doc # 2000-0011755 (Jan 11/01); 2000-0015105 (Jan 11/01)
CRA Doc # 2001-0069965 (Mar 19/01)

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Gifts Made by a Testator Involving Trusts

- **For example:**
  - **Gifts made from a spousal trust after the intervening life interest of the surviving spouse**
  - **Gifts made from income and/or capital of a testamentary trust (other than a spousal trust) established under a will**

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Overview of Issues

- **Gift made by will**
- **Gift by trust**
- **Distribution in satisfaction of income and/or capital interest of charity**

Gift Made by Will

- **In order for a gift made from a testamentary trust to qualify as a gift made by will if there is an intervening life interest, the trustees must not have any power to encroach on the capital of the trust during lifetime of the life tenant**

CRA Doc # 9732295 (Mar 20/98); IT 22R Gifts to a charity of a residue interest in real property or an equitable interest in a trust; O'Brien v. MNR (1991) 91 DTC, 1344 (TC) CRA 9811782; #2001- 0117823 (May 1/02); #9811782 (Feb 11/99); #4732295 (Mar 20/90)

Gift by trust

- **Where a gift made from capital of a trust does not qualify as a gift made by will, the trust may be entitled to claim the donation tax credit**
- **In case of a gift to charity following death of a life tenant of a spousal trust, CRA says that the property must actually be transferred to the charity in taxation year of spouse's death to reduce income arising from deemed disposition of its capital property. Problem if spouse dies before end of year – reluctance of trustee to distribute without clearance certificate**

Is it a gift or is it a distribution in satisfaction of income and/or capital interest of charity as a beneficiary?

- **In order for a distribution from an estate or testamentary trust to a charity to qualify as a gift made by the estate or trust the following factors must be present**
  - **The executors/trustees must be empowered to make gifts to charities**
  - **The executors/trustees must be exercising discretion as to whether or not to make gifts to charities**
  - **The distribution of property to the charity must be considered as a "gift" ie: a voluntary transfer of property without consideration**
  - **Recipient charity must not be receiving the distribution of property from the estate/trust in satisfaction of its interest in the estate/trust**
  - **The transfer of property in question cannot be considered a "gift by will"**

Conclusion

- **Lack of case law in this area**
  - **This has been dealt with by CRA on a case-by-case basis, expressed in various technical interpretations to address specific circumstances that arises from time to time but lacking a consistent approach**
- **Care must be exercised in structuring donations in wills and trusts to achieve desired tax result**

2. GIFTS OF LIFE INSURANCE*

- **Methods to fund charitable bequest or donation**
  - **Charity owned insurance policy**
  - **Donor owned insurance policy**

•* This is based on presentations made by Joel Cuperfain, RBC Dominion Securities

Charity Owned Policy

- **Donor gifts existing policy to Charity**
- **Donor applies for policy and gifts to charity**
- **Donor pays premiums annually and gets charity receipt for amount gifted to charity**
- **Result**
  - **Disposition at CSV**
  - **May result in income inclusion for donor**
  - **Donor gets tax receipt for value**
- **Value of gift**
  - **Old CRA position (IT 244R3): Value = CSV**
  - **New CRA position (APFF 2007 Round Table) = Value = fair market value**

Value of Gift

• **CSV**	**$20,000**
• **FMV**	**$30,000**
• **Old position**	**$20,000 charity receipt**
• **New position**	**$30,000 charity receipt**

Charity owned policy

- **Pros**
  - **New position will encourage gifts of existing life insurance policies**
  - **Annual premiums will generate current tax credits/deduction**
  - **Charity receives lump sum on death/has certainty of receipt of death benefit**
  - **Premiums receipted will not be subject to DQ rules if subject to 10 year trust/direction**
  - **Insurance proceeds will not be subject to probate tax, creditors of deceased, estate litigation**
- **Cons**
  - **Donor has no rights to policy**
  - **If donor does not pay premiums charity either has to pay or can take CSV**

Donor Owned Policy

- **Donor owns policy and designates charity as beneficiary**
  - **No longer necessary for insurance proceeds to flow through estate**
  - **Similar to direct designation of charitable gifts of RRSP/RRIFs**

Donor Owned Policy

- **Pros**
  - **Lump sum payment to Charity on death**
  - **Tax credit/deduction in year of death with one year carryback**
  - **Flexibility to donor to change mind and designate different beneficiary**
  - **Is enduring property so no impact on DQ**
- **Cons**
  - **No current tax credit/deduction for premium payments**
  - **Tax credit on death may not be fully used**

Estate Replacement Example

- **Invest tax refund in life insurance contract to provide estate replacement**
- **Example**
  - **Gift publicly traded securities**
    - **FMD** **$270,000**
    - **ACB** **$150,000**
    - **Capital Gain** **$ 0**
    - **Taxable Capital Gain** **$ 0**
    - **Other Income** **$400,000**
    - **Charity Tax Credit** **$125,000**
  - **Invest tax savings of $125,000 to purchase life insurance. Could fund $800,000 death benefit (assuming 50 yr old female non smoker 5% interest rates)**

3. PRIVATE COMPANY SHARES

- **Private company shares can be effective gifting tool**
- **However implementation and ongoing management of such gifts more complex/costly**

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Publicly Traded Securities

- **Charitable credit at full market value**
- **Capital gains on disposition of the shares to charity not included in taxable income**

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a) Income Tax Considerations for the Donor

- **Donation tax credit not available**
  - **Tax incentive for gifts of publicly traded securities not available**
- **Generally no charity receipt if non-qualifying security**
- **Non qualifying security**
  - **Non-arm's length debt obligations**
  - **Private company shares**
  - **Other non-arm's length arrangements through trusts/estates**
- **Exception - shares gifted to charitable organizations/public foundations and donor at arm's length**
- **Trap – if shares → debt after gift**

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- **RDTOH**
  - **Redemption of shares by charity shareholder may → refund of RDTOH**

    So Donor → tax credit

    Company → RDTOH

    Charity → value of shares

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- **Deemed FMV**
  - **Draft legislation introduced Feb 27, 2004 - To stop "buy low-donate high" and other tax shelter gifting arrangements**
  - **Potential punitive tax consequences for private company shares gifts (e.g., estate freezes and other corporate reorganizations?)**

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- **Rule:**
  - **Property acquired through a "gifting arrangement", in contemplation of gift or donated within 3 years of acquisition**
  - **Deemed fair market value- lesser of FMV and donor's cost**
  - **Exceptions include publicly traded shares, certified cultural property, real property in Canada, inventory and ecological gifts, and gifts on death.**
  - **Exception for shares subject to estate freeze arrangements**

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b) Income Tax Considerations for the Charity

- **Donation receipt**
  - **Fair market value of shares – what is value if can't redeem for some time**
- **Disbursement quota issues**
  - **Enduring property?**
  - **If hold shares for some time → dividends to cover 3-5% DQ and administrative costs**
- **Control of corporation**
- **Excess business holding rules: do not apply if gift is to public foundation or charitable organization**

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c) Regulatory Considerations for the Charity **(non-income tax)**

- **Corporate Powers**
- ***Trustee Act***
- ***Charitable Gifts Act – Good Government Act*** **2009 proposes this Act be repealed – the CGA had limited ability of charities to own more than 10% interest in a business or to undertake business activities**

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4. EFFECTIVE GIVING USING HOLDING COMPANY – PERSONAL GIVING VS. CORPORATE GIVING*

- **Individuals**
  - **Tax credit**
  - **Carry forward 5 years**
  - **Tax savings from donations**
  - **(% of donation depends on province)**
  - **Charitable donation limit : 75% (100% on death)**
- **Corporations**
  - **Similar except tax donation not tax credit**
  - **Slightly higher tax savings because % deduction higher**
  - **No year of death increase**

* This is based on a presentation by Jo-Anne Ryan – TD Waterhouse at a recent STEP conference

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Donation of Publicly Traded Securities to Charitable Organizations or Public Foundations

- **By Individual**
  - **No capital gains tax on gift**
  - **Significant tax incentive for funding major gifts**
- **By Corporation**
  - **No capital gains tax on gift**
  - **Significant tax incentive for funding major gifts**
  - **100% of capital gain credited to Capital Dividend Account (CDA)**

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Capital Dividend Account

- **Keeps track of various tax free surpluses accumulated by a private corporation. These surpluses may be distributed as capital dividends free of tax to the Canadian resident shareholders. CDA helps ensure that tax integration is achieved. Tax integration means that taxes paid by individual taxpayer should be same whether income is earned directly by individual or indirectly through corporation.**
- **Comprised of non taxable portion of capital gains**
- **Life insurance proceeds in excess of ACB**
- **Capital dividends from other corporations**

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Example

SALE
- **Corporation sells securities for $100,000 having ACB of 0**
- **Taxable gain is $50,000**
- **non taxable gain is $50,000 which is added to CDA and can be distributed to shareholder on tax free basis**

- **CHARITABLE GIFT**
  - **Corporation gifts securities to charity having FMV of $100,000**
  - **Tax free portion added to CDA = $100,000**
  - **Thus $100,000 available for tax free distribution to shareholder**

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Life Insurance Received by Corporation

- **Corporation is owner and beneficiary of insurance policy having death benefit of $1,000,000.**
- **$1,000,000 received as insurance proceeds by Corporation is added to CDA and can be distributed to shareholder on tax free basis**

Use of Holding Company

- **Protect excess earnings from creditors of operating company**
- **Centralize investment function in corporate group**
- **Source of retirement income**
- **After tax earnings of operating company transferred to holding corporation as tax free inter corporate dividend**
- **Transfer personal investments to holding company to avoid probate tax and/or minimize US estate tax**

Taxation of Holding Company

- **Tax on earned income**
- **Distribution to shareholder taxed in hands of shareholder**
- **On death of shareholder, capital gains tax paid by estate**

- If corporation makes charitable gift the tax is reduced at all three levels
  - Donation tax receipt reduces taxable income at corporate level
  - Donation adds to CDA which can be distributed to shareholder tax free
  - Donation and distribution reduce capital gain on death
  - Can use some of the tax savings to buy life insurance policy. Further tax savings could be achieved if life insurance is donated to charity for additional tax free distribution or the life insurance proceeds can be distributed as tax free capital dividends thus increasing the net estate to fund estate liquidity needs or maximize net estate for distribution to the heirs

5. FLOW THROUGH SHARES (FTS)

- Flow through shares are publicly traded securities in the resource sector
- Corporations can flow through tax deductions to investor/shareholder
- Deduction reduces tax cost basis of shares
- Tax effective gifting vehicle

Example: investor buys FTS

- ACB $1,000
- Deductions of $1,000 for exploration expenses leading to $460 tax savings (assume 46% tax rate)
- Donor gifts the shares to charity (other than private foundation)
- Assume value is still $1,000 thus tax credit is $460

a) Income Tax Considerations for the Donor

• Charitable gift	$1,000
• Tax deduction	$460
• Donation tax credit tax savings	$460
• No tax on gain arising from gift of shares to charity	
• Actual cost to donor ($1,000 -$460X2)	$80

b) Income Tax Considerations for the Charity

- Date of gift considerations
- Valuation issues:
  - Hold periods
  - Maintenance of value
  - Marketability of shares after hold period
- Policy re. closing bid price or midpoint between high and low trading values

6. LIMITED PARTNERSHIP INTERESTS

- Increasing requests to receive gifts of limited partnership interests
- Limited partnerships are very different from general partnerships and are usually set up by companies that invest money in other businesses or real estate

a) **Income Tax Considerations for the Donor**

- **Donation tax deduction or credit for the FMV of the interest**
- **50% of any capital gain would be included in income and subject to tax, unless a publicly listed security**

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b) **Income Tax Considerations for Charity**

- **CRA Position: The charity would be considered to be carrying on a business if it becomes a limited partner in a partnership and subject to possible revocation**
- **The fact that the principal activity of the partnership is the investment of funds did not change their view**
- **But, consider whether position would be the same if donation consists of limited partnership units which are publicly listed, widely held, and sold immediately upon receipt**

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7. **INTEREST IN A HEDGE FUND**

- **Investment advisers increasingly asking charities to accept gifts of units in a hedge fund and issue tax receipts for them**
- **Hedge funds are a specialized kind of investment. They are usually addressed to sophisticated investors and are privately offered, and thus may escape the regulatory controls placed on investments sold to the public, such as mutual funds**

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- **Canadian donors and charities access hedge funds through a number of different forms including managed accounts, pooled funds and derivatives**
- **Retail investors usually holed interests in pooled funds, which are usually structured as limited partnerships or trusts**

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a) Income Tax Considerations for the Donor

- **Donation tax deduction or credit for the FMV of the interest**
- **50% of any capital gain would be included in income and subject to tax, unless a publicly listed security**

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b) Income Tax Considerations for the Charity

- **Will depend on the nature of the underlying interest, unit in a limited partnership or a trust**
- **If limited partnership interest, see concerns above**
- **CRA position: The *Income Tax Act* allows charities to accept a gift like an interest in a hedge fund (Registered Charities Newsletter No. 8 — Spring 1999)**

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- **CRA intends to closely examine the valuation of these gifts**
- **Independent, expert appraisals (with access to all relevant facts) must be obtained to determine the FMV of the fund units when the gift is made**
- **Any tax receipt issued should carry the name and address of the appraiser**

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