FASKEN MARTINEAU

# Selected Tax Aspects of Planned Giving

Canadian Cancer Society

Professionals' Seminar on Charitable Gifts

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## Overview

- Introduction - charity donations / credits
- Gifts by Will
- RRSP / RRIF / life insurance
- Charitable remainder trusts
- Gifts of publicly traded shares
- Traps
  - Non-qualifying securities
  - Loanbacks
- Charitable Annuities
- Split receipting
- Gifts of mortgaged property

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## I. Introduction - Annual Ceiling for Charitable Gifts

- General rule:
  - 75% of net income

    +
  - 25% of taxable capital gain arising from gift to qualified donee

    +
  - 25% of recapture of depreciation arising from gift to qualified donee
- Year of Death:
  - 100% of donor's net income

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## Donations in Excess of Ceiling

- General rule:
  - Excess gifts may be carried forward for up to five years
- Year of Death:
  - Excess donations may be carried back to year preceding year of death

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## 2. Gifts by Will

- Deemed to have been made immediately *before* the individual died
- Higher ceiling (100% of net income) available
- Credit may be used in terminal return to offset tax liability arising from deemed disposition on death and in return for year prior to year of death

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## Has a Gift Been Made by Will?

1. Prior life interest
2. Who decides the amount and the recipient of gift: testator or trustees?
   - Former position:
     - Testator must specify amount or percentage of residue to be gifted to charity
     - Charities had to be specifically named in will
   - Current position:
     - No longer required to name a specific charity or group of charities

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## Has a Gift Been Made by Will?

3. Existence of Charity

- Not necessary for charity to be in existence at the time of the donor's death in order for there to be gift by will
- Will may direct executors to establish a charity after the death of the donor

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## 3. RRSP / RRIF / Life Insurance

- Donations of life insurance policy
  - Donate policy
  - Designate the proceeds
  - Reminder: Only premiums made <u>after</u> the transfer date of ownership of policy can be receipted
- Prior to 2000 Federal Budget, donors required to flow RRSP / RRIF / Life Insurance proceeds through estate to obtain charitable tax credit
- Now, can designate charity directly
  - Save probate tax
  - Protect against creditors

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## 4. Charitable Remainder Trust (CRT)

- What is a CRT?
  - A form of deferred giving in which a charity is gifted an equitable interest in the capital of the trust
  - The charity is entitled to the capital only *after* the expiration of the prior income interests in the trust
  - Entails a transfer of property to a trust today with the requirement that the charity will not receive any property from the trust until some future date
  - Examples include testamentary spouse trusts with remainder to charity and inter vivos trusts for the benefit of the settlor with remainder to charity

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## Charitable Remainder Trust (CRT)

- Benefits of CRT
  - Benefits to both donors and donees
  - Donor receives a tax credit at time of trust settlement but may retain entitlement to income earned in the trust throughout his/her life
  - Donee charity will receive (eventually) significantly more money than if it just relied upon an annual cash drive (as with most forms of deferred giving)

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## Charitable Remainder Trust (CRT)

- Trust must be irrevocable
- May be either inter vivos or testamentary
- Power of encroachment during the life tenancy will bar the issuance of a charitable gift receipt (although it will not invalidate the trust)

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## Charitable Remainder Trust (CRT)

- Valuation of gift
  - Charity is being gifted an equitable interest in the capital of the trust that it will receive upon termination of prior interests
  - The aim of the valuation process is to determine what a reasonable person would pay today in order to have this capital of the trust X years from now

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## Charitable Remainder Trust (CRT)

- Factors:
  - Current interest rates
  - Anticipated future economic conditions
  - Age of income beneficiaries
  - Mortality tables

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## Charitable Remainder Trust (CRT)

- Additional gifts to CRT
  - CCRA recently indicated that an additional transfer of property to the charitable remainder trust is not a receiptable gift
  - Rationale is that no new gift is being given to the beneficiary charity of the trust

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## Charitable Remainder Trust (CRT)

- Determination of capital gains tax liability on settlement of CRT
  - CCRA's current position is that there is a disposition at FMV of the whole property transferred to the trust, even if the settlor takes back an income interest
  - Except where rollover is available (i.e. spousal trust or alter ego trust), the transfer of capital property to charitable remainder trust will result in deemed realization of capital gains

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## Charitable Remainder Trust (CRT)

- Whether the trust is inter vivos or testamentary, the donor will be deemed under the *Income Tax Act* to have received proceeds of disposition equal to the fair market value of the transferred property
- Appropriate rate of inclusion for capital gains realized upon transfer of capital property to charitable remainder trust is 1/2

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## 5. Gifts of Publicly Traded Shares

- Extra advantage
- Only 1/4 of taxable capital gains needs to be included in income
- Full fair market value of gift = value of the donation
- Gift must be made to public foundation or organization

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## Traps

- Non-qualifying securities
  - Private company shares
  - Private company debt
- Loanbacks

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## Excepted Gifts: Exception to Non-Qualifying Security

- Share
- Donated to a charity other than a private foundation
- Donor deals at arm's length with the charity
- Donor deals at arm's length with every director, trustee, officer or like official of the charity

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## Restrictions Regarding Donation of Non-Qualifying Securities

- Charitable tax credit is available only when:
  1. Non-qualifying security ceases to be a non-qualifying security within five years of date of donation and is still held by the charity
     - At that time the charitable tax credit is equal to the lesser of the FMV of the security at that time and the FMV at the time of donation

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## Restrictions Regarding Donation of Non-Qualifying Securities

2. Donee charity disposes of the non-qualifying security within five years of the date of donation
   - Where the gift is disposed of by the charity, the charitable tax credit is equal to the lesser of the FMV of the consideration and the FMV at the time of donation

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## Loanbacks

- Arrangement whereby a donor gifts property to a charity but continues to benefit from the use of the property
- Assume for example:
  - Gift of property made to charity
  - Property is not a non-qualifying security
  - If the property is a non-qualifying security, it is an excepted gift
  - Within five years of the date of the gift, one of the following circumstances exists

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## Loanbacks

(a) Example #1:

- Year 0:
  - Donor gifts cash to charity
- Year -5 to 5:
  - Charity loans money to the donor or a person, corporation or partnership that does not deal at arm's length with the donor

(b) Example #2:

- Year 0:
  - Donor (who is a board member) donates to charity
- Year -5 to 5:
  - Donor enters into agreement with charity allowing his family to use certain property of the charity, property is not used by donor to further the charitable activities of the charity

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## Consequences

- Circumstance #1
  - FMV of gift is reduced by FMV of the consideration paid by charity to acquire the non-qualifying security
- Circumstance #2
  - FMV of gift is reduced by FMV of the use of the property

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## 6. Charitable Annuities

- What is a charitable annuity?
  - Donor makes irrevocable contribution of capital to registered charity in exchange for immediate guaranteed payments from the charity
    - i.e. $100,000 capital contribution in exchange for guaranteed payments of $8,000 per year for 10 years

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## Charitable Annuities

- Which charities may participate in this form of fundraising?
  - Charitable foundations prohibited from issuing charitable annuities since they are prohibited from incurring debt
  - Charitable organizations may issue charitable annuities if authorized by constating documents and applicable federal and provincial legislation

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## Tax Consequences of Charitable Annuities

- Before December 21, 2002:
  - Charitable gift receipt available to donor equal to amount by which capital contribution exceeds expected payments under annuity
  - Income inclusion to donor equal to amount by which payments under annuity exceed capital contribution

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## Tax Consequences of Charitable Annuities

- Before December 21, 2002:
  - Example:
    - $100,000 capital contribution to charitable organization in exchange for $10,000 per year for rest of donor's life
    - life expectancy is 8 years (assume donor lives 8 years)
    - cost of annuity that will provide $80,000 over 8 years is $50,000
    - Tax result:
      - Charitable Gift Receipt = $20,000<br>($100,000 - (8 x $10,000))
      - Income Inclusion = nil<br>i.e. annuity payments are received tax free

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## Tax Consequences of Charitable Annuities

- After December 20, 2002:
  - Charitable gift receipt available to donor equal to amount by which capital contribution exceeds the amount that would be paid at that time to an arms length third party to acquire an annuity to fund the guaranteed payment
  - Income inclusion to donor equal to amount by which payments under annuity exceed value of the annuity so determined (i.e. arms length purchase price)

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## Tax Consequences of Charitable Annuities

- After December 20, 2002:
  - Example:
    - $100,000 capital contribution to charitable organization in exchange for $10,000 per year for rest of donor's life
    - life expectancy is 8 years (assume donor lives 8 years)
    - cost of annuity that will provide $80,000 over 8 years is $50,000
    - Tax result:
      - Charitable Gift Receipt = $50,000 ($100,000 - $50,000)
      - Income Inclusion = $30,000 over 8 years ($80,000 - $50,000)

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## Gifts of Mortgaged Property

- Pre-December 20, 2002
  - Gift of mortgaged property not considered a ‘gift’ because donor received benefits of being relieved of the responsibility of the mortgage
    - Another issue - private and public foundation cannot assume a debt except for permitted debts
    - Jabs Construction

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## Gifts of Mortgaged Property

- Post-December 20, 2003
  - Fact that property comes with a debt obligation (i.e. mortgage) will not in and of itself preclude it from being a receiptable gift
  - All relevant factors need to be taken into account in valuing the “gift portion”
    - including terms and conditions of the mortgage (interest rate, term)
  - charitable foundations still prohibited from incurring most debts

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## Split Receipting

- What is "Split Receipting"?
  - Donor transfers property to charity in exchange for an advantage
    - i.e. donor transfers property worth $1,000 to charity for $100 of consideration

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## Tax Consequences of Split Receipting

- Before December 21, 2002
  - With few exceptions, where the donor receives an advantage for transferring property to charity, the transfer is not a receiptable gift
  - Exceptions to this general rule set out in IT-110R3
    - i.e. benefits of nominal value
    - excess of ticket price for dinner, ball, concert or show over FMV of ticket

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## Tax Consequences of Split Receipting

- After December 20, 2002
  - Donor transferring property to charity may receive an advantage from the charity without necessarily disqualifying the gift as a receiptable gift
  - Receiptable portion of gift is equal to amount by which the value of property transferred to charity exceeds the value of the advantage received by donor

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## Tax Consequences of Split Receipting

- After December 20, 2002
  - 3 key requirements
    - 1. Voluntary transfer of property to charity with clearly ascertainable value
    - 2. Value of any advantage received by the donor must be ascertainable
    - 3. Donor must have donative intent to enrich the charity
      - if value of advantage exceeds 80% of the value of the property transferred to the charity, the donor may have positive obligation to establish to satisfaction of CCRA the existence of donative intent

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