


## PLANNED GIVING FOR HIGH NET WORTH CLIENTS

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### A. INTRODUCTION

- **Elimination Of Taxable Capital Gains In Respect Of Certain Gifts**
- **Charitable Remainder Trusts**
- **Charitable Donations Made Through Wills**
- **Use Of Private Foundations**

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### B. ELIMINATION OF TAXABLE CAPITAL GAINS IN RESPECT OF CERTAIN GIFTS

**1. Budget 2006**

- May 2, 2006, the government announced the elimination of tax on capital gains incurred on the donation of publicly listed shares and ecologically sensitive property
- Generally, a gift of property will trigger a capital gain if the FMV of the property exceeds its adjusted cost base (ACB)

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- For most gifts of property, 50% of the capital gain is included in income for the year and is subject to tax
- For example, a gift of land that an individual paid \$100 for (the ACB) and which now has a FMV of \$1,000, will result in a capital gain of \$900 and a taxable capital gain (the amount she will have to include in her taxable income) of \$450

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- Assuming that she is taxed at the top marginal tax rate of 46%, she would pay \$207 in tax on the donation. Of course, she will also be able to claim a donation tax credit 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)

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- Now, with the Budget 2006 measures, 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 \$460 will be available to be used against other sources of income
- This makes donations of such property even more attractive than cash, since the cost of the donation to individual in the first place was only \$100

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**2. 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

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- An investor receives shares issued by the corporation as consideration and the deductions available to the corporation in relation to resource expenditures are flowed-through to investor
- The expenditures deducted by the investor grind the cost base of the shares
- 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

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- 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

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- Assuming that the value of the shares remains \$1,000, the investor will be entitled to a donation tax credit in respect of the \$1,000 donation, 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

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- 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

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### 3. Valuation

- Determine the date of the gift of publicly traded shares:
  - certificate hand-delivered to the charity - gift made when the charity receives and accepts gift
  - certificate is mailed to the charity - deeming rule in paragraph 248(7)(a) applies to deem the charity to receive the certificate on the day it was mailed, provided that the charity accepts the gift

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- electronic transfers - 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 does not provide guidance in determining how a gift of shares should be valued, CRA has 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

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- Other factors to consider:
  - the size of the block of shares
  - 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
  - whether the shares were thinly traded

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- 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*

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- 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 issues a certificate which is applicable for the two-year period following the determination

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#### 4. Provincial Rules

- Ontario tax treatment of donations of publicly-traded shares and ecological gifts will parallel the federal measures and both would be exempt from the corporate minimum tax
- 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 to other types of property, in particular to real property

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### C. CHARITABLE REMAINDER TRUSTS

- Rules related to charitable remainder trusts have not kept pace with other changes to the sector
- Rules not express in the Act, based on CRA technical interpretations and administrative positions
- Rules currently under review

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- 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)
- The settlor receives an immediate donation tax receipt

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**I. CRA’s General Position**

- CRA requirements (IT-226R)
  - residual interest 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
  - must be irrevocable
  - 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

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- the value of the gift must be ascertainable at the time of that the trust is settled
- there must be no possibility of encroachment on the capital during the existence of the life interest, eg. payment of remuneration or fees out of the capital of the trust, distributions of unrealized capital gains and returns of capital
- The method of valuing the residual interest will vary according to the type of gift, the fair market value of the property, current interest rates, the life expectancy of any life tenants, current term tables, anticipated future economic conditions and any other relevant factors

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- Transfers of private corporation shares or units in a mutual fund trust may be very difficult to value
- It is 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

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- 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
- However, paragraph 8 of IT-226R provides for 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

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

- The donor is able 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
- If a testamentary trust, the settlor can provide for an income beneficiary during their lifetime, while at the same time guaranteeing a significant donation to charity and providing the estate with some tax relief

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- 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
- Since the 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

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### 3. Concerns Regarding Charitable Remainder Trusts

- The main concern 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
- The favourable treatment given to charitable gifts of publicly listed shares does not apply to shares used to fund a charitable remainder trust

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- CRA's administrative positions with respect to some of the issues surrounding charitable remainder trusts may not be correct
- Is it the entire property which is disposed of to the trust? This disregards the bundle of rights theory of property - 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
- Questions remain concerning the impact of a residual gift through a charitable remainder trust on the donor's donation limit
- What is the cost to the trust of the transfer?

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### D. CHARITABLE DONATIONS MADE THROUGH WILLS

- The Act provides tax relief to a donor for charitable gifts during his/her life time
- Tax relief is even greater for gifts made as a result of the donor's death
- Making charitable gifts through wills may be done in a variety of ways
- The availability of the donation tax credit will depend on the circumstances in each case and the manner in which the will is drafted

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

- Subsection 118.1(5) deems a gift made by an individual's will to have been made by the individual immediately *before* death
- 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

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Donation tax credit may be claimed in the individual's terminal tax return or in the year immediately prior to death

- 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 may be entitled to a charitable donation credit pursuant to subsection 118.1(3)

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- 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

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

- Little case law dealing with what would constitute a gift made by will pursuant to subsection 118.1(5)
- Has been in accordance with CRA's interpretation

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- Previously, CRA took a restrictive view - the terms of the will must expressly provide a specific property, a specific amount or a specific percentage of the residue of the estate 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
- In 2001, CRA's views have relaxed

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**3. Gifts Made by a Testator without involving any Trusts**

- For example:
  - outright legacies and bequests
  - gifts made from the residue of an estate where there is no intervening life interest
  - gifts over to charities in the event that the beneficiaries under the will predecease or disclaim the gifts

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**Overview of Topics**

- Intention of testator
- Identity of charities to receive gifts
- Quantum of gifts
- Timing to complete gifts

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**a) Intention of testator**


- The terms of the will must show that the testator has a clear intention to make a donation to a registered charity

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

- CRA previously required the identity of the charity to receive the gift be expressly set out in the will
- This restrictive view has been relaxed in recent years in several respects

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

- CRA previously did not permit trustees to choose from a list of charities to receive gifts from the estate
- In 2001, CRA changed its view
- Now acceptable for a will to 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, provided that:

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- the actions taken by the executor are reasonable and in accordance with the terms of the will
- the donation is made to a charity
- Also acceptable that 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

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

- In 2001, CRA accepted a gift by will to a private foundation to be established by the testator's estate
- It is questionable whether this view could be applied to charitable organizations or public foundations established after the death of the testator

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**c) Quantum of gifts**

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

- 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
- May be problematic if the trustees have discretion to decide on the quantum of a gift

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

- 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

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**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, 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
- Because donations above the minimum would be purely within the discretion of the trustees

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

- The will may provide for the donation of a specific percentage of the residue of an estate to a charity
- In some situations, acceptable for the will to provide for a formula determining the amount of the residue of the estate

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**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
- In a 2004 technical interpretation, pursuant to the terms of the will, a surviving spouse selected which pieces of artwork 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
- Acceptable because the executor did not have any discretion on whether the painting will be donated

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**d) Timing to complete gifts**

- 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 the time limitation for reassessments)

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

- CRA generally requires the will to clearly specify what is to be paid from the estate
- Possible for trustees to 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 as to the form of the gift
  - the will permits a gift to be made in cash or *in specie*

**f) Conditions attached to gifts**

- Conditions attached to gifts are acceptable

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**4. 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 Topics**

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

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**a) Gift made by will**

- 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.
- The trust must not have any power to encroach on the capital of the trust before gifts are made

**b) Gift by trust**

- Where a gift made from capital of a trust does not satisfy as a gift made by will, the trust may be entitled to claim the donation tax credit pursuant to subsection 118.1(3)

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

- When a payment is made from income of a testamentary trust, it is sometimes permissible for such payment to be recognized as a distribution in satisfaction of the charity's income interest in the trust.
  - The trust may deduct such 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)

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- 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

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- 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
- Alter ego trusts
  - 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
  - Where the charity is an income beneficiary and a distribution is made out of the trust's income, subsection 104(6) would apply

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**5. 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

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**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

**Overview of Topics**

- Advantages of Using Private Foundations
- Limitations on Using Private Foundations
- Factors to Consider when Establishing a Private Foundation

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**1. Advantages of Using Private Foundations**

- Donor can retain control over assets donated to the private foundation
- Donor can retain control over the investment of the donated assets
- Donor may involve other family members in the private foundation and instil altruistic and philanthropic values in them

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- Public recognition of the donor and his/her family in the community
- Donor can “design” what charitable causes the private foundation would support
  - charitable objects set out in its constating documents
  - must be exclusively charitable in nature and within the recognized four heads of charitable purposes

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- Foundation can be used to build up an asset base for charitable work
- Foundation can hold endowment funds or make endowed gifts
- Donor can retain privacy of his/her personal affairs
- Donor can control timing of his/her gift to the foundation and the timing of making gifts by the foundation

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**2. Limitations on Using Private Foundations**

- Additional administrative and financial compliance requirements, e.g.
  - following required corporate procedures
  - corporate filings
  - filing annual Registered Charities Information Returns (Form T3010)
  - keeping adequate books and records
  - issuing donation receipts in accordance with the requirements under the Act

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- Subject to the applicable provincial statutes that apply to charities, e.g.
  - Oversight of the Ontario Public Guardian and Trustee
  - *Charities Accounting Act*
  - *Charitable Gifts Act*
  - *Trustee Act*
- Private foundation is subject to many restrictions under the Act in relation to its operations, e.g.
  - cannot carry on any business activities
  - cannot incur debts other than debts for current operating expenses, the purchase and sale of investments, or the administration of charitable activities

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- cannot acquire control of another corporation, except by gift but within limits
- must comply with the disbursement quota requirements
- Donation of publicly listed securities and ecologically sensitive land to a private foundation – no exemption of capital gains tax
- Donation of “non-qualifying securities” to private foundations is also subject to serious restrictions
  - A non-qualifying security is generally shares in a company with which the donor does not deal at arm’s length or obligations (e.g. debts) owned to the donor by a company with which the donor does not deal at arm’s length

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- Also include other non-arm’s length transactions
- Does not include a security that is listed on any of the prescribed stock exchanges set out in Regulation 3201
- Does not include “excepted gifts,” which is 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

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- A receipt may be issued if, within 5 years of the donation, either the recipient private foundation disposes of the non-qualifying security or the non-qualifying security ceasing to be a non-qualifying security
- 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, and (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

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- For a donor who has made a gift of non-qualifying security and has realized a gain from the gift, the donor may claim a reserve under subsection 40(1.01) during the 5 year period until the gift is deemed to have been made
- 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

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- Another restriction on private foundations involves rules concerning loan backs and non-qualified investments
- A donor would need to be careful not to inadvertently violate the loan back provisions
- 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

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### 3. Factors to Consider when Establishing a Private Foundation

- 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?
- 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?
- Under what jurisdiction should the foundation be incorporated?

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- How should the foundation be structured? Who would be on the board and how would the donor exercise control on 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?

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