
**CALEDON PLANNED GIVING
PLANNING A LEGACY FOR CALEDON**

November 16, 2006

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

By Terrance S. Carter, B.A., LL.B. & Trade-Mark Agent

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A. INTRODUCTION OF SELECTED TOPICS

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

For more detailed information see paper by Karen J. Cooper and Theresa L.M. Man of Carters entitled "*Planned Giving for High Net Worth Clients*" available at www.charitylaw.ca

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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)
- The net amount of the tax credit is \$460 less \$207 = \$253

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

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- 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)

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)

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- Has been in accordance with CRA's interpretation
- 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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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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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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D. USE OF PRIVATE FOUNDATIONS

- The effective use of a private foundation could be a very useful and flexible planned giving tool for an individual

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-qualifies 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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