14TH ANNUAL NATIONAL
CAGP-ACPDP CONFERENCE

Halifax – April 12, 2007

Unusual & New Gifts

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INTRODUCTION

1. Private Company Shares
2. Flow-through Shares
3. Limited Partnership Interests
4. Interest in a Hedge Fund
5. Ecological Gift
6. Gifts from Trust

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OUTLINE

- Income tax considerations for the donor
- Income tax considerations for the charity
- Regulatory considerations for the charity (non-income tax)
- Tips and traps

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

- **Donation tax credit**
  - **Tax incentive for gifts of publicly traded securities not available**
- **Non-qualifying securities**
  - **Shares/debt of private co where donor non-arm's length**
  - **Exception - shares gifted to charitable organizations/public foundations and donor at arm's length**
  - **Trap – if shares → debt after gift**
  - **Problem: no charity receipt at time of 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**
  - **Split receipting – advantage?**
- **Disbursement quota issues**
  - **Enduring property?**
  - **If hold shares for some time → dividends to cover 3-5% DQ and administrative costs**
- **Control of corporation**

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- **Budget 2007**
  - **for private foundations**
  - **new excess business holdings rules impose requirement to continuously monitor holdings and acquisitions of both publicly listed and private corporation shares**
  - **depending upon the amount of its interest in a particular class of shares of a company, a private foundation will be subject to varying requirements**

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	Private Foundation (Holdings of Share Class)	Non-Arm's Length Persons (Holdings of Share Class)	Action Required by a Foundation
1. Safe harbour	2% or less	Any percentage	None
2. Monitoring phase	5%	10%	Reporting required
	10%	10%	
	20%	0%	
3. Divestment required	25%	0%	Reduce holdings to 20%
	8%	14%	Reduce holdings to 6%[1]
	10%	17%	Reduce holdings to 3%[1]
	Above 2%	Above 18%	Reduce holdings to 2%[1]

[1] Alternatively, non-arm's length persons could reduce their holdings until the combined holdings of the foundation and non-arm's length persons did not exceed 20%.

Reproduced from Annex 5 of the Budget Plan, Department of Finance, March 19, 2007.

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

- **Corporate Powers**
- ***Trustee Act***
- ***Charitable Gifts Act***

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- ***Charitable Gifts Act***
  - **Greater than 10% interest in a business**
  - **Mandatory divestiture within 7 years**
  - **What is an "interest in a business"**
  - **Reporting requirements**
  - **Requirement to share profits**
  - **Requirements re: investment of proceeds from disposition of business interest**

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2. FLOW THROUGH SHARES (FTS)

- **Tax based financing incentives (oil and gas/mining sectors)**
- **Corporations can flow through tax deductions to investor**
- **Expenditures deducted by investor grind cost base of shares**

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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**
- **Assume value is still $1,000**

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a) Income Tax Considerations for the Donor

- **Tax deduction during hold period of $460, donation tax credit leads to tax savings of $460 and no tax on the gain arising from gift of shares to the charity**
- **Actual cost to taxpayer of the investment is $80 ($1,000 less $460 x 2) and taxpayer gets donation credit of $1,000**

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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**
- **Could Charity be considered a tax shelter promoter?**

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

- ***Trustee Act***
  - **Is ownership of FTS a prudent investment?**
  - **Is it an adventure in the nature of trade?**

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3. 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**

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- **One general partner who controls the company's day-to-day operations and who is personally liable for business debts. Limited partners contribute capital to the business (investment money) but have minimal control over daily business decisions or operations**
- **In return for giving up management power, a limited partner's personal liability is capped at the amount of his or her investment. That investment amount and no more would go toward paying off any partnership debts**

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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 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**
- **A partnership, including a limited partnership, is defined in common law as the relationship between persons carrying on business in common with a view to profit**

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- **The fact that the principal activity of the partnership was the investment of funds did not change their view**
- **CRA Document #2000-000547**
- **More recently, CRA reconsidered this position in a situation involving a private foundation located in Quebec who carried on a business through a foreign partnership created under the *Delaware Revised Uniform Partnership Act* (''DRUPA'')**

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- **CRA reconfirmed its position that entities created under DRUPA would be treated as partnerships for the purpose of the Act as long as they were carried on with an intention to earn a profit. The private foundation could be subject to revocation.**
- **CRA Document #2006-016742 and #2006-0216451**
- **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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c) Regulatory Considerations for the Charity
(non-income tax)

- **Corporate Powers**
- ***Trustee Act***
  - **Is ownership of limited partnership interests a prudent investment?**

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4. 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 hold 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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- **But, CRA has also indicated that in one investment proposal a valuation suggested to charities and potential investors was inflated in relation to the underlying value of the units**
- **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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c) Regulatory Considerations for the Charity
(non-income tax)

- **Corporate Powers**
- ***Trustee Act***
  - **Is ownership of hedge fund interests a prudent investment?**

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5. ECOLOGICAL GIFT

- **Budget 2006 measure overshadowed by public shares**
- **EGP is a specific tax incentive program designed to encourage the donation of ecologically sensitive land & certain interests in land**
- **What is ecologically sensitive land? Areas or sites that presently, or in the future, could significantly contribute to the conservation of Canada's biodiversity and natural environmental heritage**
- **Government of Canada certifies the value of ecological gift donations for income tax purposes**

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Example: Donation of a Remainder Interest

- **Sue earns $75,000 as an accountant in Halifax**
- **She has owned 6 ha of property in Lunenburg County in an area with a planning restriction that prohibits development on lots smaller than 2 ha. The land includes a picturesque and significant stretch of coastline and has been in Sue's family for over a century**
- **In recent years, large areas of Nova Scotia's southern coast have been bought up by wealthy foreign visitors for homes and cottages. Sue is concerned that there may soon be little undeveloped coastal habitat left**

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- **Sue opts to keep a life interest in the land so she may live out her days there and to donate the remainder interest to a land trust as an ecogift**
- **The land, originally valued at $80,000, is now worth $400,000. The remainder interest is worth $250,000. The land trust also enters into an agreement with Sue to use and care for the property**

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a) Income Tax Considerations for the Donor

- **Certified FMV of gift is $250,000 - it is generally the current appraised FMV of the gift less the value of the life interest (IT 226R)**
- **Taxable income is $75,000**
- **The entire amount of the donation may be used – not limited to 75% of her taxable income like other gifts**

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- **Immediate donation tax credit in year of gift even though able to continue to use the property**
- **Remainder of the donation may be carried forward for 5 years**
- **No tax on the capital gain arising as a result of the disposition of the remainder interest. No need to worry about part disposition rules or designation in 118.1(6)**

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b) Income Tax Considerations for the Charity

- Must be an eligible recipient: federal or provincial Crown, municipality or a registered charity one of the main purposes of which is the conservation and protection of Canada's environmental heritage
- No disbursement requirement if requirement to hold for ten years (neither 80% or 3.5%)
- No risk re: valuation since certified

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6. GIFTS FROM TRUSTS

a) Introduction

- Trusts play a key role in wealth preservation and succession planning for high net worth families
- For many high net worth families, a substantial portion of their wealth is held in trusts
- Yet, tax law regarding transfers from trusts to charities is relatively underdeveloped

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b) Charitable Remainder Trusts

- Traditional thinking about trusts and charities has been narrowly focused on charitable remainder trusts
- But charitable remainder trusts have some limitations, including:
  - Uncertainty regarding the receipt amount
  - Inefficiencies in the investment policy
  - Tax inefficiencies
  - Lack of flexibility
- There are other ways to use trusts to facilitate transfers to charities that potentially avoid some of those limitations

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c) Ex.1: Charitable Income Trusts

- **Typically created by Will to provide financial security for an individual and transfer surplus wealth to charity**
- **Typical trust terms:**
  - **Income and net gains are distributed to charity annually**
  - **The individual receives regular distributions of tax-free capital**
  - **On the death of the individual, the remainder goes to charity**

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d) Ex.2: Family/Philanthropy Trusts

- **Typically created as part of an estate freeze or as a succession planning vehicle after a substantial sale of assets**
- **Typical trust terms:**
  - **Completely discretionary during the lifetime of the settlor**
  - **After the death of the settlor, mandatory distribution of income (and realized gains) to charity above threshold amount**

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- **The threshold amount is determined by the settlor to be the appropriate reserve for the financial security of the family**
- **When the value of the trust property is below the threshold amount, income and net gains may be accumulated or distributed to the family or to charity**

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e) Ex.3: Gifts from Alter Ego Trusts

- **Typically established as a Will substitute in order to avoid probate fees or, in B.C., the *Wills Variation Act***
- **Typical terms:**
  - **Completely flexible during the settlor's lifetime**
  - **On the death of the settlor, a portion of the trust property is gifted to charity and a portion is distributed to family**
  - **The proportions can be changed at any time during the settlor's lifetime**

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f) Conclusion

- **Trusts play a key role in succession planning for high net worth families**
- **Designing the trusts to contemplate future transfers to charity brings philanthropy into the core of the high net worth family's long term planning**
- **Properly designed trusts can provide for transfers to charity in a manner that is tax efficient, maintains flexibility for the donor family and is compatible with preserving the financial security of the donor family**

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