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# CANADIAN LAND TRUST ALLIANCE

Ottawa – October 19, 2007

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## Recent Tax Changes and How They Affect Your Land Trust

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By Karen J. Cooper, LL.B., LL.L., TEP

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**Recent Tax Changes and How They  
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**OVERVIEW**

- A. Elimination of Capital Gains in respect of Certain Gifts
- B. Receipting
- C. Tax Shelters
- D. Disbursement Quota

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**A. ELIMINATION OF TAXABLE CAPITAL GAINS IN RESPECT OF CERTAIN GIFTS**

- 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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**B. RECEIPTING**

**1. Split-Receipting**

- Proposed draft amendments to the *Income Tax Act* create a new concept of “gift” for tax purposes which permits a donor to receive benefit, provided that the value of the property donated exceeds the benefit received by the donor
- Concept is commonly referred to as “split-receipting”

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**SUMMARY OF PROPOSED AMENDMENTS**

- A gift will permit some consideration to be received by the donor
- New split receipting rules will apply
- New broader definition of “advantage” may reduce the amount of a charitable receipt

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- Charitable donation receipts must now reflect the following formula:

$$\begin{array}{rcl} \text{Eligible Amount} & = & \text{Fair Market} \\ \text{of Gift} & & \text{Value of the} \\ & & \text{Property} \\ & & \text{Donated} \end{array} \quad - \quad \begin{array}{l} \text{Advantage} \\ \text{Received by} \\ \text{Donor} \end{array}$$

- Must be voluntary transfer of property with a clearly ascertainable value

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- Donative intent required
  - Must have a clear donative intent by the donor to benefit the charity
  - Donative intent will generally be presumed if the fair market value of the advantage does not exceed 80% of the value of the gift

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- Broad definition of "advantage" - includes:
  - The total value of all property, services, compensation, use or other benefits
  - To which the donor, or a person not dealing at arms length with the donor
  - Has received or obtained or is entitled to receive (either immediately or in the future)
  - As partial consideration of or in gratitude of the gift or that is in any other way related to the gift

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- The advantage can be provided to the donor or to a person or partnership not dealing at arm's length with the donor
- It is not necessary that the advantage be received from the charity that received the gift, i.e. the advantage could be provided by third parties unbeknownst to the charity, which fact will necessitate that charities make inquiries of donors to determine if they have received a related benefit from anyone
- CRA's administrative exemption applies where there is a token advantage of the lesser of 10% of the value of the gift and \$75 (*de minimis* threshold)

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- Example - A charity receives a gift of land from a donor who has received some type of benefit from a developer who owns property adjacent to the donated property in exchange for making the gift
- Naming rights are not advantages if there is no prospective economic benefit associated with the naming rights

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2. Receipts

- CRA has released new Guidelines regarding the imposition of new intermediate sanctions: (<http://www.cra-arc.gc.ca/tax/charities/policy/newsanctions-e.html>)
- New intermediate sanction for issuing incomplete receipts could lead to a penalty of 5% of eligible amount stated on receipt (10% for subsequent infraction)
- New intermediate sanction for issuing receipts in if there is no gift or if receipt contains false information. CRA has indicated it would likely proceed directly to revocation of charitable status

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Incomplete Receipts

- Income Tax Regulation 3501 requires:
  - Name, Registration # and address of charity
  - Serial # of receipt
  - Date and place of issue
  - Date of receipt of cash gift
  - Date of receipt and description of in-kind gift
  - Value of property received
  - Amount of advantage received by donor
  - CRA name and website URL
- See CRA Website for most recent requirements

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**Avoiding False Receipts**

- **Valuation issues:** whose is it and can it be relied on – charity should obtain its own independent valuation
- **Know your donors:** Neither valuator nor charity should turn a blind eye to facts or circumstances which may give rise to concerns

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**C. TAX SHELTERS**

- In general, tax shelters are arrangements that permit an investor to claim a tax deduction equal to a portion or even the entire amount of the investment within a short time period to create a loss in the current period from that particular source of income, and be able to reduce, therefore “shelter,” income taxes payable from other sources of income
- Originally, tax shelters usually involved investments in aircraft, movies, scientific research, resource exploration and development, and computer software

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- Repeated legislative attempts over the years to curtail the use of tax shelters
- CRA has repeatedly warned the public that the issuance of a tax shelter identification number does not indicate that CRA “guarantees an investment or authorizes any resulting tax benefits,” and that CRA “only uses this identification number later to identify unacceptable tax avoidance arrangements”

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- Summary of amendments to curtail abusive donation tax shelters proposed as of November 2006

- Deduction of "the amount of the advantage"
- Deeming the FMV of the property to be the lesser of:
  - The FMV of the property and
  - The cost (or the ACB) of the property immediately before the donation

in the following three situations:

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- (i) If the donor acquired the property through a "gifting arrangement"
- (ii) If the donor acquired the property less than 3 years before making the gift
- (iii) If the donor acquired the property less than 10 years before making the gift, if it was reasonable to conclude that when the donor acquired the property one of the main reasons for the acquisition was to make a gift (donor must prove that the donor did not have an expectation to make a gift when the property was acquired)

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- The deeming provision does not apply to inventory, real property or an immovable situated in Canada, certified cultural property, publicly traded shares and ecological gifts
- The deeming provision also does not apply where the gifts is made as a result of the donor's death, and certain other situations

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- Various CRA Fact Sheets, News Release, Taxpayer Alerts warn the public and registered charities of the risks associated with involvement in such schemes
- Most recently: For example:
  - News Release, “Beware of tax shelter gifting arrangements,” August 13, 2007
  - Taxpayer Alert, “Warning: Participating in tax shelter gifting arrangement is likely to result in a tax bill!” August 13, 2007

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- The August 13, 2007 News Release indicates that:
  - “CRA reviews all tax shelter gifting arrangements to ensure that the tax benefits being claimed meet the requirements of the *Income Tax Act*. New schemes are being marketed that claim to be different from those for which the CRA has previously issued warnings. Taxpayers should avoid all schemes that promise donation receipts equal to 3 or 4 times the cash payment.”

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- The August 13, 2007 News Release also indicates that:
  - CRA will audit every tax shelter gifting arrangement
  - CRA has audited over 26,000 individuals who have participated in these tax shelters and about \$1.4 billion in claimed donations have been denied
  - CRA will soon complete audits of another 20,000 taxpayers, involving close to \$550 million in donations
  - CRA is about to begin auditing another 50,000 taxpayers

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- In general, the challenges by CRA have been on different fronts, including whether:
  - There is a gift
  - The receipts reflect the FMV of the property
  - There is any donative intent (in some situations, the donor never had possession of the property before they were donated to charities)
  - The property was personal-use property
  - The appraisals obtained by tax shelter promoters could be relied upon when issuing the donation receipt

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- D. DISBURSEMENT QUOTA RULES**
- What is DQ?
    - A prescribed amount that registered charities must disburse each year in order to maintain their charitable registration
  - Purpose
    - To ensure charities use charitable funds on charitable activities
    - To discourage charities from spending excessive amounts on fundraising and from accumulating funds

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- 80% DQ Rule:
  - Land trusts are required to expend 80% of the previous years receipted donations in the following year unless the donation is a transfer of “enduring property”
- 3.5% DQ Rule
  - Land trusts are required to expend 3.5% of their property not used in carrying out their charitable activities, eg. investment assets, each year

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**EXTENSION OF 3.5% DQ TO CHARITABLE ORGANIZATIONS**

- Only public and private foundations had been subject to the 4.5% DQ
- The reduced 3.5% DQ will now apply to charitable organizations as well
- For charitable organizations registered after March 22, 2004, the 3.5% DQ will apply to their taxation years that begin after March 22, 2004
- For charitable organizations registered before March 23, 2004, the 3.5% DQ will apply to their taxation years that begin after 2008

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**DE MINIMIS THRESHOLD ON THE APPLICATION OF THE 3.5% DQ**

- 3.5 % DQ only applies to registered charities if they hold investment assets greater than \$25,000
- To provide relief to small charities, although it is considered generally too low for an effective threshold

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- New term “enduring property” includes 4 types of gifts or transfers that avoid the 80% DQ
  - Gifts by way of bequest or inheritance, including RRSFs, RRIFs and life insurance
  - Inter-charity gifts received by an arm’s length charitable organization to be expended in the next 5 years or less on its charitable activities
  - Ten-year gifts
  - Inter-charity transfer of ten-year gifts and gifts by way of bequest or inheritance

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1. Gifts by way of bequest or inheritance

- Includes bequests or inheritances from a donor
- Also where an individual has designated a charity as a direct beneficiary of an RRSP, RRIF or life insurance policy, the May 2005 amendments treat such gifts as enduring property for the purposes of the disbursement quota rules
- This will mean that direct designation of RRSP, RRIF and life insurance proceeds will be subject only to the 3.5% disbursement quota while they are held as capital and then subject to the 80% disbursement quota in the year in which they are disbursed

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- Applies in respect of deaths after 1998
- These gifts will no longer be limited to "gifts of capital received by way of bequests or inheritance", therefore a testamentary income interest received by a charity would be included

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2. Inter-charity gifts received by a charitable organization to be expended in the next 5 years or less in its charitable activities
- Gift received by a charitable organization from another registered charity
  - More than 50% of the directors of the donor charity deal at arm's length with each director of the donee charitable organization

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3. Ten-year gifts

- A gift from a donor to a registered charity subject to a trust or a direction that the gift is to be held for at least ten years, i.e. endowment
- A ten year gift now permits the original recipient charity or a transferee charity to expend the realized capital gains from the ten year gift before the end of 10 years as described below

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4. Inter-charity transfer of ten-year gifts and gifts by way of bequest or inheritance

- Gifts by way of bequest or inheritance and ten-year gifts (but not 5-year gifts) from either an original recipient charity or another transferee charity
- Provided that if the gift is a ten-year gift, the gift is subject to the same terms and conditions under the trust or direction

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TAX SCENARIOS

See Ecological Gifts Program, Tax Scenarios

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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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