
**CANADIAN INSTITUTE OF CHARTERED
ACCOUNTANTS (CICA)
7TH ANNUAL CONFERENCE ON INCOME TAXES**

September 16, 2008

Planned Giving Options

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

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Toronto – September 16, 2008

PLANNED GIVING OPTIONS

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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
- Status of Legislation

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

1. Elimination of taxable capital gains
 - The tax on capital gains incurred on the donation of publicly listed shares and ecologically sensitive property has been completely eliminated
 - Generally, a gift of property will trigger a capital gain if the fair market value (“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 FTS 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 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
- However, a number of advance income tax rulings have recently been issued sanctioning various structures using FTS (see also 2007APFF Question)

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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 ITA 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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C. CHARITABLE REMAINDER TRUSTS

- Rules related to charitable remainder trusts have not kept pace with other changes to the sector
- Rules not expressed in the ITA, 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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1. 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, e.g. 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) of the ITA 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 ITA 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
- Since 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 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**
- **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 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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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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E. USE OF PRIVATE FOUNDATIONS

- As of December 2005, CRA indicates that there were 4,208 private foundations registered with CRA (out of a total of 82,243 registered charities) (CRA Registered Charities Newsletter No. 27, Fall 2006)
- The effective use of a private foundation could be a very useful and flexible planned giving tool for an individual
- There may be restrictions on when it is suitable to use a private foundation

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1. What is a Private Foundation?

- **A private foundation is one of three types of registered charities identified in the ITA, namely**
 - Charitable organizations
 - Public foundations
 - Private foundations
- **Recent amendments to the ITA seem to be blurring the distinction between the types of registered charities, particularly between a charitable organization and a public foundation**

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- **A charitable foundation may be established as either a corporation or a trust — it cannot be an unincorporated association**
- **There are two types of charitable foundations: a public foundation and a private foundation**
- **Like a charitable organization, a public foundation cannot be controlled by a group of related directors/trustees**
- **A private foundation is defined in the ITA as simply a foundation which is not a public foundation**

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- **Disbursement Quota Rules**
 - **All registered charities are required to expend a portion of their assets annually in accordance with a disbursement quota (“DQ”)**
 - **The DQ rules generally involves an 80% disbursement requirement aimed at limiting administrative expenses and the 3.5% requirement aimed at preventing accumulation of funds**
 - **The DQ rules for private foundations are very similar to those for charitable organizations and public foundations, except that private foundations must expend 100% (rather than 80%) of all amounts received from other registered charities in the immediately preceding taxation year, other than specified gifts and enduring property**

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- **Related Business**
 - Charitable organizations and public foundations can carry on related businesses
 - Private foundations may not carry on any business activity
 - A private foundation that carries on business activities may be subject to a 5% penalty tax on its gross revenue from the offending activity on first infraction; increasing to 100% penalty tax on repeated infractions within 5 years, together with the suspension of receipting privileges (subsections 188.1(1), 188.1(2) and 188.2(1))
 - The private foundation’s charitable status may also be revoked (paragraph 149.1(4)(a) of the ITA)

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- **Charitable Activities**
 - Private foundations may carry on their own charitable activities, and may give funds to other qualified donees
 - It is not clear from the ITA whether there is any requirement on private foundations to give more than 50 per cent of their income annually to other qualified donees
 - CRA takes the administrative position that the language in the definition for “charitable foundation” implies that public foundations must disburse at least 50 per cent of their income to qualified donees

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- CRA also takes the administrative position that since the definition of “private foundation” in section 149.1(1) of the ITA provides that a private foundation is a charitable foundation that is *not* a public foundation, private foundations are not required to give at least 50 per cent of their income annually to other qualified donees
- **Borrowing**
 - Private foundations are prohibited from incurring debts other than debts for current operating expenses, the purchase and sale of investments or the administration of the charitable activities. (paragraph 149.1(4)(d) of the ITA)

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– CRA was of the view that these types of debts would only include a miscellaneous type of debt, such as brokerage fees or other incidental amounts related to the purchase or the sale of investments, but not debts for the purpose of purchasing investments, or using the loan proceeds to discharge debts which were, when incurred, permitted under the ITA

– In October 2005, CRA issued technical interpretation (2005-0154751I7) and revised its position to allow a foundation to incur debts for the purpose of acquiring investments

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– It is also now permitted for a foundation’s directors and members to give interest-free loans to the foundation to enable the foundation to acquire investments, pay current operating expenses or expend on charitable activities

– CRA indicated that they would continue to review debt arrangements, especially those involving non arm’s length parties, in order to ensure that there are no other issues, such as personal benefit

– See Charity Law Bulletin #86

– The same restrictions apply to public foundations, but not to charitable organizations

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• Control of Other Corporations

– Private foundations are prohibited from acquiring control of any corporation (paragraph and 149.1(4)(c) of the ITA)

– Failure to comply with this restriction may subject the private foundation to a 5% penalty tax on dividends paid to the foundation on first infraction; increasing to 100% penalty tax on repeated infractions within 5 years (paragraph 188.1(2)(a) and 188.1(3)(b))

– The charitable registration of the private foundation may also be revoked

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– Generally, control occurs when the foundation owns 50% or more of a corporation’s issued share capital, having full voting rights under all circumstances. However, a foundation that has not purchased more than 5% of these shares but is given a block of shares that brings up its total holding to more than 50% will not be considered to have acquired control of the corporation (paragraph 149.1(12)(a) of the ITA)

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• Tax treatment of donating certain gifts

- Donation of publicly listed securities and ecologically sensitive land to a private foundation –exemption of capital gains tax since 2007
- Donation of non-qualifying securities is subject to serious restrictions
- Restrictions concerning loan backs and non-qualified investments
- See section of PowerPoint on “limitations”

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• Excess Business Holdings Rules

- Budget 2007 - the government was concerned that persons connected with a private foundation, by virtue of the combined shareholdings between them and the foundation’s, might have influence that they may use for their own benefit
- The new excess business holdings rules require a private foundation to monitor its holdings of both publicly-listed and private corporation shares

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– #1 Insignificant Interest (2% or less)

- A private foundation is permitted to hold a maximum of 2% of all outstanding shares in a particular class in any one corporation

– #2 Disclosure Requirements (over 2%)

- If a private foundation’s holdings of one or more classes of shares of a company exceeds 2% of all outstanding shares, the private foundation will be required to disclose in its T3010 the name of the corporation, the foundation's holdings of that class of shares, and the total shareholdings of the “relevant persons” of that class of shares

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- A “relevant person” is generally a person who does not deal at arms length with any person who controls the private foundation, or with any member of a non arm’s length group of persons that control the foundation, with certain exemptions, such as an “estranged family member”
- The private foundation will also be required to report to CRA any “material transactions” during the year by the foundation or relevant persons for any period during which the foundation was outside the safe harbour in respect of the corporation

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- A material transaction involves the acquisition or disposition of more than \$100,000 worth of shares of a particular class or more than 0.5% of all outstanding shares of that class

– #3 Divestment Requirements (over 20%)

- If a private foundation is outside the safe harbour range and the foundation and its relevant persons together hold more than 20% of the outstanding shares of a particular class of shares of a corporation, a divestment will be required
- Penalties will be imposed if the divestment does not occur within the time periods specified by the rules

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▪ **The compliance period for divestiture of excess shares depends on the manner by which the excess arose:**

- **If the excess shares were acquired by the foundation for consideration, divestiture of the excess is required before the end of that taxation year**
- **If the excess shares were acquired by a relevant person or by a donation to the foundation by a relevant person, divestiture of the excess is required before the end of the subsequent taxation year**

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- **If the excess shares were acquired as a result of a donation from a person who is not a relevant person or the result of the redemption, acquisition or cancellation of the shares by the corporation, divestiture of the excess would be required before the end of the 2nd subsequent taxation year**
- **If the excess shares were acquired by way of a bequest, divestiture of the excess would be required before the end of the 5th subsequent taxation year**

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– Exemptions

- **No obligation to divest will be imposed on donations of shares made before March 19, 2007, that were made subject to a trust or direction that the shares be retained by the foundation, if the terms prevent the foundation from disposing of those shares**
- **The same exemption applies to donations made on or after March 19, 2007 and before March 19, 2012 pursuant to the terms of a will signed or an *inter vivos* trust settled before March 19, 2007 and not amended after that date**

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– **Penalty**

- **A penalty will apply in respect of a foundation’s excess business holdings that have not been divested as required**
- **The proposed penalty is 5% of the value of excess holdings, increasing to 10% if a second infraction occurs within 5 years**
- **A penalty tax of 10% if it fails to comply with the disclosure requirements**

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2. Advantages of Using Private Foundations

- **Donor can retain control over assets donated to the private foundation**
- **Donor can retain control over the investments of donated assets**
- **Donor may involve other family members in the private foundation and instill altruistic 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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- 3. 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 ITA**

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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 ITA 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
- Must comply with new excess business holdings regime
- 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
- Another restriction on private foundations involves rules concerning loan backs and non-qualified investments

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- Two situations trigger the loan back provisions: Within 5 years of a donor making a regular gift to a private foundation:
 - The private foundation acquires a NQS from or of the donor
 - The private foundation allows the donor (or a non-arm's length person to the donor) who is not at arm's length to the foundation, to use the foundation's property within certain time frames (subsection 118(16) and (17) of the ITA)
- A donor would need to be careful not to inadvertently violate the loan back provisions

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- 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
 - A non-qualified investment can include a debt, a share, or a right to acquire a share
 - In the case of a debt, it must be owing to the private foundations by:
 - A person who is a member, shareholder, trustee, settler, officer, official, or director of the foundation; or
 - A person who either alone, or as a member of a group of persons who do not deal with each other at arm's length, has contributed more than 50% of the capital to the foundation; or

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- A person who does not deal at arm's length with any person described above
- In the case of a corporation, a debt will be a non-qualified investment of the corporation if controlled by the private foundation, by any person or group of persons described above, by the foundation and any other private foundation with which it does not deal at arm's length, or by any combination of the above
- Will include a share in the capital stock of a corporation referred to above, held by the foundation, or held by persons not dealing at arm's length with the foundation; but shares listed on a prescribed stock exchange either within or outside Canada will not be included

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- e.g. a mortgage that a private foundation acquired from a director. The mortgagee must complete Form T2140, Part V Tax Return - Tax on Non-Qualified Investments of a Registered Charity, every fiscal year. The tax payable can be reduced by the amount of interest paid during the tax year. Accordingly, if the mortgagee decided to voluntarily pay interest to the foundation, it would reduce the amount of tax payable
- See CRA Registered Charities Newsletter No. 27 (Fall 2006)

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4. 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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- F. STATUS OF LEGISLATION**
1. **October 2007, Bill C-10 - Proposed Amendments to the *Income Tax Act* Affecting Charities**
- **On October 29, 2007, Bill C-10 was introduced to address a lengthy list of proposed amendments to the ITA**
 - **Bill C-10 amends and consolidates earlier proposed amendments released on December 20, 2002, December 5, 2003, February 27, 2004, July 18, 2005 and November 18, 2006**
 - **Bill C-10 is expected to die on the order paper**

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- **Some of the more significant changes proposed by Bill C-10 involve the introduction of**
 - **Split-receipting rules**
 - **Provisions which curtail abusive donation tax shelter schemes**
 - **New definitions for charitable organizations and public foundations**
 - **The new definition replaces the “contribution test” with a “control test”**
 - **Charities that do not meet this test will be designated as private foundations**

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2. 2007 Federal Budget Passed as Bill C-28

- The March 19, 2007 Budget (“2007 Budget”) introduced a number of important measures for charities
- The 2007 was legislated in Bill C-28, which received Royal Assent on December 14, 2007, subject to amendments in the February 26, 2008 Budget
- Extension of Capital Gains Exemption to Private Foundations
- Excess Business Holdings Rules

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3. 2008 Federal Budget

- The February 26, 2008 Federal Budget proposes a number of measures which will impact registered charities
- Bill C-50, an act to implement certain provisions of the 2008 Budget, received Royal Assent on June 18, 2008, and includes some but not all of the 2008 Budget’s provisions dealing with charities

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Included in Bill C-50

- Provisions to extend the capital gains tax exemption to donations of unlisted securities that are exchanged for publicly traded securities before being gifted to a registered charity on or after February 26, 2008, within 30 days of the exchange

Not included in Bill C-50

- The 2008 Budget’s measures to amend the excess business holding rules that were enacted in December 2007, by
 - Exempting certain unlisted shares that were held on March 18, 2007 from the divestiture requirements, subject to certain exceptions

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- New rules with respect to shares held on March 18, 2007 by “non arm’s-length” trusts considered to be “relevant persons” of a private foundation
- Introducing concept of “substituted shares”
 - Generally “substituted shares” are shares acquired by a person in the context of a corporate reorganization in exchange for other shares
 - “Substituted shares” will be treated the same as the shares for which they were exchanged for purposes of applying the exemption from the excess business holding rules
- Extending anti-avoidance provisions to address certain inappropriate uses of trusts

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