
**CANADIAN ASSOCIATION OF GIFT PLANNERS
CAGP-ACPDPTM Annual National Conference**

Edmonton – May 13, 2010

**BASIC TAX CONSIDERATIONS
IN GIFT PLANNING**

**By Terrance S. Carter – Carters Professional Corporation
and Laura West – Fasken Martineau DuMoulin LLP**

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Introduction


- Overview of topics
 - Basic treatment of gifts under the *Income Tax Act* (“ITA”)
 - What are the tax benefits under the ITA when making a gift?
 - Gifts in kind
 - Gifts of capital property
 - Special rules regarding gifts by will
 - Other rules regarding gifts of special property




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- Resource materials
 - See Canada Revenue Agency (“CRA”)
 - P113(E) Rev. 09 Gifts and Income Tax Act
 - online: <http://www.cra-arc.gc.ca/E/pub/tg/p113/p113-e.html>
 - See Terrance Carter, “Tax Credits” and “Capital Gains Exemption” online at: <http://www.carters.ca/pub/article/charity/2009/tsc0418a.pdf> and <http://www.carters.ca/pub/article/charity/2009/tsc0418b.pdf>
 - See also M.E. Hoffstein, Theresa L.M. Man and Laura West, “When Is an Advantage Not an Advantage – Issues Arising From the Proposed Split-receipting Regime” online: <http://www.carters.ca/pub/article/charity/2006/mehtmlew0511.pdf>



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1. The Basic Treatment Of Gifts Under The Income Tax Act (“ITA”)

a) What Is a Gift?

- The traditional common law definition of a gift requires:
 - The donor must have an intention to give
 - There must be a transfer of property
 - The transfer must be made voluntarily; and
 - No consideration or advantage can be received by the donor

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- However, on December 20, 2002, the Department of Finance released draft legislation containing proposed amendments to the ITA to create a new concept of “gift” for tax purposes to enable split-receipting
- The proposed amendments have gone through various iterations, with the last being Bill C-10, which died on order paper when Parliament dissolved on September 7, 2008
- The amendments are expected to be reintroduced
- However, CRA administratively operates as though the amendments are already in force

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b) What Is the “Eligible Amount of Gift”?

- ss. 248(31) of the ITA introduces the defined concept of “eligible amount of gift”


Eligible	=	Fair Market	–	Any Advantage
Amount of		Value of		Received by
Gift		the Property		Donor
		Donated		

- A receipt may be issued for the “eligible amount of gift”
- If the donor makes a donation where the advantage exceeds 80% of the FMV of the property given and donative intent cannot be shown, the donation will not be considered a gift

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c) **What Is the “Fair Market Value of the Property Donated”?**

- Fair market value (“FMV”) is generally the highest dollar value that a donor can get for property in an open and unrestricted market between a willing buyer and a willing seller who are acting independently of each other
- However, the FMV must be ascertainable
- If the FMV of an item cannot be reasonably ascertained, an official donation receipt cannot be issued


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d) **What Is an “Advantage” for the Purpose of Calculating the “Eligible Amount”?**

- Broad definition of “advantage” under ss. 248(32), which 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” must be clearly identified and its value ascertainable
- The “advantage” can be provided to the donor or to a person or partnership not dealing at arm’s length with the donor
- The “advantage” can be received prior to, at the same time, or subsequent to the making of the gift
- 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, this will necessitate that charities make inquiries of donors to determine if they have received a related benefit from anyone

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e) **“De minimis” Exemption to “Advantage”**

- CRA’s administrative exemption to “advantage” applies where there is a token “advantage” of the lesser of 10% of the value of the gift and \$75 (*de minimis* threshold)
- CRA has indicated that the *de minimis* threshold will not apply to cash or near cash type of advantages, such as redeemable gift certificates, vouchers and coupons

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f) **What Is Not a Gift for Purposes of the ITA?**

- Examples of transactions that do not constitute a “gift”:
 - Pledged amounts which are not yet received
 - Donation of services
 - Payment of sponsorship fees
 - Loans to the charity which are not forgiven
 - Provision of free use of property
 - Donations which are court ordered or otherwise compelled to be given

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2. **What Are The Tax Benefits Under The ITA When Making A Gift?**

a) **What Are the Tax Benefits of a Gift by an Individual to a “Qualified Donee”?**

- ss. 118.1(3) of the ITA provides a non-refundable tax credit for individuals
- A tax credit reduces the total tax payable for the taxation year the credit is used as opposed to deduction from net income
- The credit is limited to 75% of the donor’s net income
- The gift or any amount in excess of the annual limit can be carried forward five years, provided that an amount or portion of an amount is claimed only once

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- A two-tier tax credit system applies
- On the first \$200 of donations, a credit at the lowest marginal rate applies, i.e. currently 15% federally (21.05% combined rate in Ontario)
- For donations in excess of \$200, the tax credit increases to the highest marginal rate, i.e., currently 29% federally (46.41% combined rate in Ontario)
- Example: Mary donates \$1000 cash. She can claim a tax credit in Ontario of:

$$(21\% \times \$200) + (46\% \times \$800) = \$410$$

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b) What Are the Tax Benefits of a Gift by a Corporation to a “Qualified Donee”?

- ss. 110.1(1) of the ITA provides a deduction for corporations of up to 75% of net income of the total amount of the eligible amounts of any gifts made in the year or 5 subsequent years
- Note that the deduction is applied to reduce the taxable income of the corporation, whereas the tax credit for an individual reduces the tax payable
- If the corporation is reporting nil (\$0) income or a loss for the year, the deduction cannot be used to create or increase a loss

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c) What Is a “Qualified Donee” for the Purposes of Gifting?

- A tax credit or a deduction can be claimed based on the eligible amount of the gift to a “qualified donee”
- A “qualified donee” is defined under s. 248(1) of the ITA as:
 - A registered Canadian charity
 - A registered Canadian amateur athletic association
 - A Canadian tax-exempt housing corporation that only provides low-cost housing for seniors

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- A municipality in Canada, or under proposed changes, for gifts made after May 8, 2000, a municipal or public body performing a function of government in Canada
- The United Nations and its related agencies
- A prescribed university outside Canada
- A charitable organization outside Canada to which the Government of Canada has made a donation in the tax year, or the previous tax year; and
- The Government of Canada, a province, or a territory

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d) What about Gifts to U.S Charities?

- Under the Article XXI(6) of the *Canada-United States Income Tax Convention, 1980*, a Canadian donor may claim a charitable tax credit for gifts to a U.S charity, provided U.S. charity is resident in the U.S. and is generally exempt from U.S. tax that could qualify in Canada as a registered charity if it were a resident in Canada and created or established in Canada
- CRA has indicated that an organization that qualifies in the U.S for section 501(c)(3) of the Internal Revenue Code status will meet the above test

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- However, such credits are restricted to only 75% of the donors net U.S-source income
- Gifts to U.S charities will not be limited to only U.S-source income but will instead be applied to 75% of net world income where a Canadian lives near the border and commutes to work in the U.S and:
 - The person's chief source of income is the U.S employer, and
 - The donation is made to a religious, charitable, scientific literary or education organization in the U.S

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e) **What about Gifts Made in the Year of Death?**

- A tax credit may be claimed on gifts that the deceased person gave in the year of death, including those that the person bequeathed in his or her will
- The amount claimed must be the lesser of:
 - 100% of the person’s income for the year; or
 - Eligible amount of the gifts donated in the year of death (including gifts by will), plus the unclaimed portion of any gifts made in the five years before the year of death
- Any excess may be claimed in the return for the previous year for up to 100% of net income

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3. Gifts In Kind

a) **What Is a Gift in Kind?**

- A gift in kind involves the voluntary transfer of property, other than cash to a charity, and includes capital property, depreciable property, personal use property and inventory, but does not include the provision of services to a charity
- Includes books, art work or art collections, archival documentation, works or material, equipment, software, and other intangible property

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b) **Valuation of Gifts in Kind**

- A gift in kind must be valued at FMV
- If the FMV of the property is less than \$1,000, a member of the registered charity, or another individual, with sufficient knowledge of the property may determine its value, but the donor should keep all documents used to determine the FMV in case CRA asks that they be produced
- If the FMV of the property is expected to be greater than \$1,000, CRA strongly recommends that it be appraised by an independent third party

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c) Application of “Deemed Fair Market Value” Rules

- Need to determine the FMV of gifts in kind
- FMV of donated property will be deemed to be the lesser of
 - The actual FMV of the property and
 - The cost (or the adjusted cost base where applicable) of the property to the donor immediately before the gift is made in the following three situations:
 - i) If the donor acquired the property through a “gifting arrangement” i.e. a donation tax shelter scheme,

- ii) If the donor acquired the property less than 3 years before making the gift, or
- 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)

- Need to “look-back” to see if the property had been acquired within the 3 or 10 years by a non arms-length person and if so then the “deemed fair market value” rule applies to that person

- The deeming disposition rules do not apply to inventory, real property or an immovable situated in Canada, certified cultural property, publicly traded shares and ecological gifts
- The deeming provisions also do not apply
 - Where the gift is made as a consequence of the donor’s death
 - A shareholder has transferred property to a controlled corporation in exchange for shares and the shares are donated, or a rollover transaction to a corporation for the same purpose of donating shares
 - Where the donor has acquired property from a transferor (such as a spouse) on a tax-deferred rollover basis

4. Gifts of Capital Property

a) Deemed Disposition of Gifts of Capital Property

- “Capital property” is broadly defined in s. 54 of the ITA as any property that is depreciable or will give rise to a capital gain or loss when disposed of
- Taxation of capital gains occur by including a portion of the capital gain in the tax payers income
- Capital gains inclusion rate is currently 50%
- Capital gains are not taxed until the property is sold

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- Under para. 69(1)(b) of the ITA, gifts of capital property are deemed to have been disposed of at their FMV
- Under ss. 110.1(3) and 118.1(6) of the ITA, a donor of capital property is permitted to elect any value between the adjusted cost base (“ACB”) and FMV for determining the proceeds of disposition and the amount of the gift
- The ACB is generally the cost of acquiring the property plus any expenses to acquire it
- The elected amount cannot be less than the amount of the “advantage” under ss. 248(32) of the ITA

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b) Special Rules for Gifts of Capital Property that are Exempted from the Capital Gains Inclusion

- Exemption for Publicly Traded Securities
 - As of 2006, donations of publicly traded securities (“listed securities” under the ITA) result in a capital gain inclusion rate of zero
 - In March 2007, the exemption was extended to private foundations
 - Common publicly traded securities (“listed securities”)
 - A share, debt obligation or right listed on a designated stock exchange
 - A share of the capital stock of a mutual fund corporation
 - A unit of a mutual fund trust

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– **Date of a gift of publicly traded securities:**

- **Certificate hand-delivered to the charity - gift made when the charity receives and accepts gift**
- **Certificate is mailed to the charity - deeming rule in para. 248(7)(a) of the ITA applies to deem the charity to receive the certificate on the day it was mailed, provided that the charity accepts the gift**
- **Electronic transfers – 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**

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• **Gifts of Ecologically Sensitive Land**

- **An ecological gift is a donation of land or a partial interest in land, such as conservation easement, covenant or servitude**
- **Pursuant to sub. para. 38(1)(a.2) of the ITA, no capital gains inclusion occurs on the gift, except gifts to private foundations**
- **May be claimed up to 100% of net income**
- **However, the recipient of an ecological gift must be an “eligible recipient”, which if it is a registered charity, must be approved by the Minister of the Environment (of which there are approximately 190 such charities)**

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- **An eligible recipient is:**
 - **Territorial, provincial or federal departments or agencies**
 - **A municipality**
 - **An approved registered charity whose main purpose is the conservation and protection of the environment**
- **The land must then be certified to be “ecologically sensitive land”**
- **The FMV must be certified by the government through the appraisal review panel**

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- **Gifts of Cultural Property**
 - Gifts of cultural property (art, sculptures, archival material, etc.) must be certified by the Canadian Cultural Property Export Review Board (“CCPERB”) as being of outstanding significance and national importance
 - The CCPERB determines the FMV of the property
 - The recipient of the gift of cultural property must be a “designated institution or public authority”, which generally includes museums and art galleries across Canada

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- Pursuant to sub. para. 39(1)(a)(i.1) of the ITA, there is no capital gain inclusion on the gift
- The gift may be claimed against up to 100% of net income
- If the recipient disposes of the gifted property within 10 years of the CCPERB having certified the property and the donation made, the recipient may be subject to a tax on 30% of the FMV of the property
- CRA may waive collection of this tax if they are notified in advance and provided with a sufficient reason for the disposition

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5. Special Rules Regarding Gifts By Wills

- Tax advantages of charitable giving are increased on death
- Making charitable gifts through wills may be accomplished in a variety of ways
- The tax advantages available will depend on the type of charitable gift made and the manner in which the will is drafted

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a) Income Taxation on Death

- **ss. 70(5) of the ITA deems every individual to have disposed of all of his or her capital property immediately before death for FMV**
- **As a result, any accrued capital gain or capital loss will be realized for income tax purposes on the deceased’s final income tax return – often capital gains taxes arise as a result**
- **Deferrals of such capital gains tax liability are available if capital property is transferred to the individual’s spouse or a qualifying spouse trust (ss. 70(6) of the ITA)**

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b) Advantages of Charitable Giving on Death

- **ss. 118.1(5) of the ITA deems a gift made by an individual’s will to have been made by the individual immediately before death**
- **ss. 118.1(4) of the ITA 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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- **As a result, donation tax credits arising from “Gifts by Will” can be claimed in the individual’s terminal return (or in the year immediately prior to death) to offset any capital gains taxes arising as a result of the deemed disposition of capital property arising on death**
- **Tax credits can be applied against up to 100% of the individual’s income in the year of death and the immediately preceding year**


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c) What Is a “Gift by Will”?


- Many ways to make distributions to charities through wills including:
 - Cash bequests or gifts of specific assets (e.g. artwork)
 - Establishment of a testamentary trust which provides that an individual (e.g., a spouse) is the income and/or capital beneficiary during his or her lifetime and the charity is to receive the remainder of the trust property on the individual’s death
 - A charity is one of many potential beneficiaries of a discretionary testamentary trust
 - A charity is a contingent beneficiary in the event that the first-named beneficiary dies or disclaims the gift

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- Not all of these distributions will necessarily constitute “Gifts by Will” for the purposes of ss. 118.1(5) of the ITA
- Very little case law on what constitutes a “Gift by Will”
- Therefore, need to rely on CRA policy statements, which have significantly changed over recent years
- Criteria considered as to whether a “Gift by Will” qualifies under ss. 118.1(5):
 - Quantum of Gift
 - Form of Property Gifted
 - Recipients of Gift

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- Quantum of Gift
 - The will must provide for a specific amount to be gifted or a specific percentage of the residue must be stipulated
 - If Trustees have the discretion to decide on the quantum of gift, may not be “Gift by Will” for purposes of ss. 118.1(5) of the ITA
 - Specific issues to watch out for: (i) discretion of Trustees to provide gifts within minimum and maximum ranges; and (ii) use of a formula to calculate the amount donated
- Forms of Property Gifted
 - Trustees can have the discretion to decide the form of property to be donated – e.g., a gift of cash or a gift *in specie*
 - Conditions attached to gifts are acceptable

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- **Recipients of Gift**
 - Trustees may have discretion to pay a stipulated amount to one or more listed registered charities or they can have complete discretion to decide what registered charities receive the stipulated amount (i.e., where no charities listed)
 - “Gift by Will” allowed where will directs a gift to be made to a private foundation to be established following the testator’s death
- **Testamentary Trusts with Intervening Life Interests**
 - If there is an intervening life interest, in order for a gift made from a testamentary trust to qualify as a “Gift by Will”, the Trustees must have no power to encroach on the capital of the testamentary trust during the lifetime of the life tenant

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d) If it Is Not a “Gift by Will” Is it Either:

- A gift by an estate or testamentary trust?
- A distribution in satisfaction of the charity’s interest as a beneficiary in a testamentary trust?
- In order to qualify as a gift (and charitable tax credits under ss. 118.1(3) of the ITA of up to 75% of the income of the estate/trust), the CRA has indicated in various policy statements that certain criteria must be met

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- **Criteria Include:**
 - The executors/trustees must be empowered to make the gifts to charity
 - The executors/trustees must be exercising discretion as to whether or not to make gifts to charities
 - The distribution of property to the charity must be considered as a “gift” – i.e., a voluntary transfer of property without consideration
 - Recipient charity must not be receiving the distribution of property from the estate/trust in satisfaction of its interest in the estate/trust
 - The transfer of property in question cannot be considered a “Gift by Will”

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- **Complex area with divergent policy statements from the CRA – careful consideration needed**
- **Care must be taken in structuring donations in wills and testamentary trusts to ensure desired tax result**
- **Questions to ask:**
 - **Is it a “Gift by Will”? – tax credit available in year of death**
 - **Is it a gift by an estate/trust? – tax credit available to estate/trust**
 - **Is it a distribution in satisfaction of income or capital interest in a trust? – no tax credit available**

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6. Rules Regarding Gifts of Special Property

a) **Endowments**

- **Generally, an endowment is a gift made subject to a restriction that the capital of the property donated be held in trust for a certain period of time and sometimes for a specified purpose**
- **The disbursement quota rules in effect prior to Budget 2010 created incentives for the making of endowed gifts – as gifts subject to a trust or direction that the capital be held for a period of at least 10 years (“Ten Year Gifts”) were excluded from the 80% disbursement quota**
- **Budget 2010 has proposed the abolishment of the 80% disbursement quota obligation and the concept of Ten Year Gifts and other “enduring property”**

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- **Endowed gifts may still be utilized by charities – either at the instigation of the donor or potentially the charity**
- **Disbursement quota benefits of Ten Year Gifts will no longer be relevant – key for most charities will be flexibility in terms and conditions of endowments**
- **Restrictive terms and conditions can be problematic because:**
 - **Less flexibility for the charity with respect to the making of distributions**
 - **May impact ability of charity to meet its 3.5% disbursement quota obligations**
 - **Greater administrative costs**
 - **Difficulties in making necessary amendments as times and circumstances change**

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b) Life Insurance

- **Many options for charitable giving involving life insurance**
 - Donor may gift the ownership of an existing or new life insurance policy to a charity
 - Policy may be fully paid-up or premiums may need to be paid
 - Donor may retain ownership interest in life insurance policy and designate the charity as the beneficiary of the life insurance policy

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- **Gift of ownership of insurance policy**
 - Current charitable receipt for donation – what is the value?
 - Previous CRA position (IT-244R3) – cash surrender value of policy
 - Current CRA position (See CRA Technical Interpretation 2008-0267091E5 and Document #2009-0316701C6) – FMV as determined by a number of factors
 - If donor pays premiums annually, will receive annual charitable receipts for the amounts gifted. If donor does not pay premiums, charity either has to pay the premiums or take the cash surrender value of the policy

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- **Designation of Charity as Beneficiary of Insurance Policy**
 - Lump sum payment to charity on death with tax credit in year of death with one-year carry-back (ss.118.1(5.1) and (5.2) of the ITA)
 - Donor can change beneficiary designation at any time
 - No current tax credit available to donor
 - Tax credit on death may not be fully utilized
 - Potential estate planning tax benefits – minimization of probate tax, capital gains tax

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c) RRSPs and RRIFs

- Donors can designate a charity as beneficiary of a RRSP or RRIF on his or her death
 - Payment to charity on death with tax credit in year of death with one-year carry-back (ss. 118.1(5.3) of the ITA)
 - Estate planning benefits – minimization of probate tax, etc.
- Donors can make a bequest in their will that the value of the RRSP or RRIF proceeds be given to charity
 - Potential loss of estate planning benefits, as RRSP or RRIF proceeds will form part of the estate of the donor

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d) Charitable Gift Annuities

- An arrangement under which a donor contributes funds to a charitable organization in exchange for guaranteed payments for life at a specified rate depending on life expectancy or for a fixed term
- Public and private foundations are restricted from incurring debt obligations except for specific purposes (operating expenses, purchase and sale of investments and debts incurred in the course of administering charitable activities) See ss. 149.1(3)(d) and 149.1(4)(d) of the ITA
- Therefore, public and private foundations cannot enter into charitable gift annuity arrangements with donors

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- Split receipting rules will apply to charitable gift annuities. According to Income Tax Technical News Number 26:

“Where an amount is contributed to a charitable organization by a donor, and the advantage received by the donor is a stream of guaranteed payments for a period of time, the eligible amount will be equal to the excess of the amount contributed by the donor over the amount that would be paid at that time to an arm’s length third party to acquire an annuity to fund the guaranteed payments.”

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e) Charitable remainder trusts

- Can be testamentary or *inter vivos* (during lifetime)
- Involves the transfer of property to a trust where the donor (or a named beneficiary such as a spouse or child) retains a life or income interest in the trust but an irrevocable gift of the residual interest is made to a charity
- The recipient charity can issue an official donation receipt for the FMV of the residual interest at the time that the residual interest vests in the charity provided that a number of requirements are met

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- These requirements include:
 - There must be a transfer of property
 - The property must vest with the recipient charity at the time of transfer
 - A gift is vested if:
 - The person or persons entitled to the gift are in existence and are ascertained;
 - The size of the beneficiaries' interests are ascertained; and
 - Any conditions attached to the gift are satisfied
 - The transfer must be irrevocable
 - It must be evident that the recipient organization will eventually receive full ownership and possession of the property transferred

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- The FMV of the residual interest is a complex valuation exercise – professional assistance usually required
- According to CRA Policy (IT-226R):
 - “The general approach is to value the various interests taking into consideration the fair market value of the property itself, the current interest rates, the life expectancy of any life tenants, and any other factors relevant to the specific case”
 - “In cases where the size of a residual or equitable interest at the time of the donation cannot reasonably be determined, such as when a life tenant or trustee has a right to encroach on the capital of the trust, no deduction or tax credit in respect of the donation will be allowed”

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f) Private Company Shares

- No similar capital gains tax incentives as with publicly traded securities (i.e., capital gains on donor’s disposition of shares to the charity will be included in taxable income)
- Can be an effective gifting tool but implementation and management of such gifts may be more complex
- If “non-qualifying security”, no charitable receipt available at the time that the gift is made but may be available at later date if certain criteria are met

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- “Non-qualifying securities” are generally gifts of securities that are not publicly listed and are either shares in a company with which the donor does not deal at arm’s length, or obligations (such as debts) owed to the donor by a company with which the donor does not deal at arm’s length.
- Excluded from the rules applicable to “non-qualifying securities” are “excepted gifts”
- An “excepted gift” must meet three conditions:
 - The security is in the form of a share;
 - The charity receiving the gift is a charitable organization or a public foundation; and
 - The donor deals at arm’s length with the charity, and with each director, trustee, officer, and similar official of the charity

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- If in the next 5 years, the charity sells or otherwise disposes of the non-qualifying security, or the non-qualifying security ceases to be a non-qualifying security, a charitable receipt can be issued to the donor, with the amount of the receipt being the lesser of:
 - The FMV of the non-qualifying security when the charity received the gift; and
 - Either the amount the registered charity is able to obtain when it sells or otherwise disposes of the non-qualifying security or its FMV when it ceased to be a non-qualifying security

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- **Other Issues to Consider When Dealing with Private Company Shares**
 - **Complex valuation issues – what is the eligible amount of the gift?**
 - **Are the deemed FMV rules applicable?**
 - **Does the acquisition of the shares result in the charity gaining control of a corporation?**
 - **Does the acquisition of the shares result in the charity being seen to carry on a business or a business that is not a related business?**
 - **Are the excess business holdings rules applicable?**
 - **Is the retention of the shares a prudent investment of the charity for trust law purposes?**

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