CARTERS

BARRISTERS
SOLICITORS
TRADEMARK AGENTS

ONTARIO BAR ASSOCIATION'S INSTITUTE 2015

Toronto – February 4, 2015

Gifting Issues

By Theresa L.M. Man, B.Sc, M.Mus, LL.B., LL.M.

tman@carters.ca
1-877-942-0001

CARTERS PROFESSIONAL CORPORATION
TOLL FREE: 1-877-942-0001

Toronto Ottawa Orangeville Mississauga
www.carters.ca www.charitylaw.ca www.antiterrorismlaw.ca

2

OVERVIEW

Recent Case Law Related to Gifting Issues

Estate Donation Rules Introduced by Budget 2014

www.charitylaw.ca www.carters.ca

3

A. Recent Case Law Related to Gifting Issues

- Gift at Common Law vs Gift for Income Tax Purposes - *Neville* Case
- Conditional Gift - *Norman Estate* Case
- Recent false receipting cases
  - Seven cases in November 2014
  - Other cases in 2014

www.charitylaw.ca www.carters.ca

4

1. *Neville v National Foundation for Christian Leadership*

- Issue - whether a charity had to return "donations" made because CRA disallowed a related tax credit
- Facts - Nevilles donated $6,250 to NFCL in 2002; their daughter received two scholarships from NFCL in 2002 and 2003 totalling $6,408
- CRA denied tax credit
- TCC found that the donations were not gifts for income tax purposes because the donors either knew or ought to have known that if they made a donation to NFCL, their children would receive a bursary or scholarship from NFCL
- The Nevilles lost at the FCA, and leave to appeal to the SCC was refused

www.charitylaw.ca www.carters.ca

5

- Nevilles sued NFCL to return the donations
  - Nevilles argued that the gifts should be returned because they were not gifts for ITA purposes
  - Lost at BCSC, appeal to BCCA lost, leave to appeal to SCC refused
  - Court held that donations were not gifts for income tax purpose, but they are gifts at common law – with donative intent, delivery, and acceptance
  - The purpose of the gift was to donate to a foundation that supported Christian students attending Christian schools, not to obtain tax benefit
  - Accordingly, the primary purpose of the gift was fulfilled and the gift was not vitiated

www.charitylaw.ca www.carters.ca

6

- A material benefit associated by a gift could disqualify a gift for income tax purposes
- Gift for income tax purposes is not the same as gift at common law
- Donors who intend for their donations to receive tax benefits under the ITA should ensure that the donations will qualify as gifts both at common law and under the ITA
- Common law and ITA issues to consider if a gift is to be returned (ss. 118.1(25) to (28) and ss.110.1(14) to (17) of the ITA introduced by the Federal Budget in 2011)

www.charitylaw.ca www.carters.ca

2. *Norman Estate v Watch Tower Bible and Tract Society of Canada*

- Issue – validity of a donation provided for pursuant to a conditional donation agreement
- Facts – Donors entered into a conditional gift agreement so that a gift made by the donors would be returned to the donors upon request and any unreturned gift upon the donors' death would be the property of the charity

- The court held that the conditional agreement created an *inter vivos* trust because the donors intended the agreement to have immediate effect and the agreement created gifts with a subsequent condition
  - Therefore, the Society can keep the gift and did not need to return it to the donor's estate
- This decision underlines the importance of charities being careful when drafting conditional donation agreements if they want to ensure that any gift given under such an agreement will remain with the charity after the death of the donor

9

3. Seven Recent Tax Court False Receipting Cases

- 7 cases released in November 2014 - *Abbotaleby-Pour, Bani, Izkendar, Vekkal, Rasuli, Nocon, Komarynsky*
- All seven cases related to a donation scheme operated by the accountants involving the issuance of approximately $12 million in false charitable donation receipts
- The Court disallowed false receipts in all cases
- The accountants were charged with fraud for making false statements on the related income tax returns
- CRA presented common evidence focussing on abnormally large donation patterns representing a significant portion of the donors' incomes

www.charitylaw.ca www.carters.ca

10

- The Court found that the appellants knowingly purchased false donation receipts in all cases and cannot deny responsibility based on the bad advice of their accountants
- Taxpayers cannot use excuses such as bad advice, misguided trust, momentary lapses of judgment, or not reviewing their returns and they must take responsibility for their own actions and roles within the tax system
- Even though the accountants instigated the false donation receipt scheme, the Court held that the appellants "should not be spared"

www.charitylaw.ca www.carters.ca

4. Other False Receipting Cases in 2014

- ***Hassan* case**
  - In May 2014, TCC denied a claim for charitable tax credit for donations totalling $25,000
  - TCC found that the receipt for $25,000 was based upon an alleged $300 donation and a pledge of $25,000
  - The Court did not believe the $300 donation was made at all, and a pledge cannot be receipted
  - Although it was unclear whether Hassan was complicit or merely duped, the Court found that "it appears almost certain that the program involved a fraud on the Canadian tax system, and therefore on the Canadian public"

- **Series of 5 cases in summer 2014**
  - *Ampomah, McCalla, Akinbo, Imoh, Bello* cases
  - Cases show the importance of donors being able to provide objective evidence to donations made and that the evidence is verifiable
  - The Court cited various evidentiary problems including: failing to call a witness with knowledge of events; strength of CRA's audit evidence; improbability of donation amounts based on net income; lack of connection to the donee charity; inconsistent statements; and general lack of documentary evidence to corroborate claims

13

- The cases illustrate when a taxpayer can made donations in cash, but the Court noted that, when doing so, the taxpayer “imposes on (oneself) the burden of having some means of verifying the otherwise untraceable transactions”
- The Court rejected the appellants’ argument that their good faith should negate the deficiencies of the receipts issued because “it is not a matter of fault, responsibility, good faith or bad faith,” but it is mandatory that receipts must comply with the requirements in ITA and the Regulations

www.charitylaw.ca www.carters.ca

14

- **Series of 6 cases in April 2014**
  - *David et al* cases
  - TCC issued one set of reasons for 6 Informal Procedure appeals concerning alleged charitable gifts made to a charity involving a tax return preparer
  - CRA assumed that the appellants paid 10% of the face amount of the receipts and an additional unspecified amount as a commission, but none of the appellants provided any contemporaneous to refute the assumption
  - The Court found the testimonies of the appellants too vague, too brief to be convincing, and implausible

www.charitylaw.ca www.carters.ca

15

- The Court rejected the appellants' argument that they should be allowed a tax credit based on the face amount of the inflated tax receipts issued because they should have been warned by CRA regarding concerns about the charity

- The Court rejected the Minister's argument that an inflated tax receipt should be regarded as a benefit that would negate a gift
- The Court allowed the charitable tax credit for 10% of the receipt's face amount
- Although the Court did not have the jurisdiction to waive interest on the tax owing, the Court vacated all penalties levied against the appellants

www.charitylaw.ca www.carters.ca

16

B. New Estate Donation Rules in Budget 2014

- Budget 2014 contained some surprise new tax incentives for charitable donations

Bill C-31, *Economic Action Plan 2014 Act, No. 1*, which received Royal Assent on June 19, 2014

- 10 year (instead of 5) carry-forward period for gifts of ecologically sensitive land
- Removing the exemption for gifts of cultural property made as part of a tax shelter gifting arrangement
- Minister power refuse to register a charity or revoke its registration if it is accepts a "gift" from a "foreign state" listed in the *State Immunity Act*

Bill C-43, *Economic Action Plan 2014, No. 2,* which received Royal Assent on December 16, 2014

- New rules regarding estate gifts

www.charitylaw.ca www.carters.ca

17

1. Current Rules for Deaths Before 2016

- Current tax rules governing estate gifts in place before Budget 2014 will continue to apply for gifts that arise as a result of deaths that occur before 2016
- A gift made by an individual through a will (a "gift by will") is deemed to have been made by the individual immediately before death
- A gift made in the year of death is deemed to have been made in the year immediately prior to death - the donation tax credit can be claimed in the individual's terminal tax return or in the year immediately prior to death

www.charitylaw.ca www.carters.ca

18

- Value of a non-cash donation is its fair-market value on the date of death (not the date when the charity received the gifted property)
- Where an individual designated a charity as the recipient of the proceeds under RRSP, RRIF, TFSA or life insurance policy, the gift is deemed to be made immediately before the individual's death
- Maximum amount of donations that may be claimed in a year is 100% of an individual's net income in the year of the donor's death and the immediately preceding year (normal limit is 75%)

www.charitylaw.ca www.carters.ca

19

- If a gift made as a result of a person's death does not satisfy as a gift by will, it will be considered to be a gift by the estate, and the maximum charitable donation credit is only 75% of the income of the estate
- Determining whether a gift qualifies as a gift by will or by estate has been a key consideration in estate planning in order to obtain the desired tax results
- The determination has been a complex area, little case law, depends on positions taken by CRA in its various interpretation bulletins, technical interpretations and rulings

www.charitylaw.ca www.carters.ca

20

- In general, to be a gift by will, CRA requires the following requirements be met
  - the terms of the will provide for a donation of a specific property, a specific amount or a specific percentage of the residue of the estate
  - it is clear from the terms of the will that the executors are required to make the donation
  - the estate is in a position to make the donation after the payment of debts
  - the donation is actually made
- CRA would generally determine that a gift is made by the estate if the estate trustee has the discretion to determine the amount of gift, whether a gift is to be made, and the charity to which to make the gift

www.charitylaw.ca www.carters.ca

21

- Concerns of current rules
  - Not flexible enough regarding when a donation tax credit was available
  - Complex determination of gift by will vs gift by estate
  - Valuation issue if value of gift at time when it is received by the charity is different from value on death

www.charitylaw.ca www.carters.ca

22

2. New Rules for Death After 2015

- New rules apply to gifts as a result of deaths that occur after 2015
- All estate gifts will be deemed to be made by the estate at the time at which the gift property is transferred to the charity
  - Regardless of whether the gift would otherwise be categorized as a gift by will or a gift by the estate under the old regime
- Same deeming rules for designated RRSPs, RRIFs, TFSAs and life insurance policies
- Value of a non-cash donation will be fair-market value on the date of the transfer (no longer the date of death)

www.charitylaw.ca www.carters.ca

23

- New rules will provide greater flexibility in claiming donation tax credits if the gift meets all of the following requirements
  – Gift is made by the deceased's "graduated rate estate" (GRE)
  – Gift is transferred to a qualified donee within the first 36 months after the individual's death (GRE can only last 36 months after death)
  – Gifted property must have been received by the estate on and as a consequence of the individual's death or have been subtitled for such property

www.charitylaw.ca www.carters.ca

24

- Estate trustees will have more flexibility to allocate the donation made by will among any of the following
  – the taxation year of the estate in which the donation is made
  – an earlier taxation year of the estate
  – the terminal or last taxation year of the deceased person
  – the year before the terminal year of the deceased person
- Since a GRE can only exist for 3 years, this means that the estate trustee can allocate the gift within a maximum of 5 year time frame

www.charitylaw.ca www.carters.ca

25

- The current rule that 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 will continue to apply
- An estate will continue to be able to claim a donation tax credit in respect of other donations in the year in which the donation is made or in any of the 5 following years

www.charitylaw.ca www.carters.ca

26

- "Graduated rate estate" (a "GRE")
  - An estate that arises on and as a consequence of the death of an individual
  - Qualifies as a testamentary trust
  - Provides for the social insurance number of the deceased individual on the estate's tax return
  - Designated by the estate as a GRE in its first estate tax return that ends after 2015
- An estate will only qualify to be a GRE for 36 months from the date of the individual's death
- Only one estate can be designated as the GRE for a deceased individual

www.charitylaw.ca www.carters.ca

27

- GRE will be taxed at graduated tax rate and can have an off-calendar year, among other features
- Other than GREs and "qualified disability trusts, all other trusts (including testamentary trusts that do not qualify as GREs, estates and *inter vivos* trusts) will be taxed the flat top marginal rate, must have a calendar year end, must remit quarterly instalments, etc.
- Serious impact on estate administration and planning

www.charitylaw.ca www.carters.ca

28

3. Implications of the New Rules

- New rules provide greater flexibility in a number of respects, however there are many unanswered issues, and concerns still remain
- Estates trustees can allocate gifts within a maximum of 5 year time frame - 2 years before death and 3 years of the GRE
- Greater certainty on the date of a testamentary gift by prescribing that the date of the gift is the date when the gift is received by the charity (not the date of death)

www.charitylaw.ca www.carters.ca

29

- All testamentary gifts will be deemed to be gifts made by the estate, no longer need to determine if it is a gift by will vs gift by estate – but clear ITA language to clarify this is preferable
- The requirement that the property of the gift must be received by the estate on and as a consequence of the individual's death or have been subtitled for such property may cause hardship
  - Estates cannot borrow funds in order to make a qualifying estate gift
  - E.g., if the estate's funds are somehow tied up for more than 3 years and the estate would be prevented from borrowing funds to make the gifts before the 36 month limit runs out

www.charitylaw.ca www.carters.ca

30

- The requirement that qualifying gifts must be made within 36 months after death may not be practical
  - Will impose greater pressure on estate trustees to administer the estate as soon as possible within this time frame if they want to take advantage of the greater tax benefits under the new rules
  - In practice, there are many situations where a gift may not be able to be made within this period and the 36 month period does not do justice to taking these circumstances into account, e.g.,
    - Get clearance certificate before distribution
    - Estate disputes, litigation or seek court direction to clarify the terms of the will
    - Dispose of illiquid assets

www.charitylaw.ca www.carters.ca

31

- New rules do not address the treatment of gifts to a charity on the death of an intervening life interest
  - E.g., for qualifying spousal trusts, the donation will be deferred until the death of the surviving spouse
  - Application of new rules is problematic
  - Upon death of taxpayer - residual interest in a charitable remainder trust is a property interest that can be given to charity
  - Very likely to be able to make the gift within 3 years after death of taxpayer – how long will the life interest last?
- With the new estate donation rules not applying until death occurring after 2015, it remains to be seen whether the ITA will be amended in 2015 to address these issues

www.charitylaw.ca www.carters.ca

CARTERS
BARRISTERS
SOLICITORS
TRADEMARK AGENTS

Disclaimer

CARTERS PROFESSIONAL CORPORATION
TOLL FREE: 1-877-942-0001
Toronto Ottawa Orangeville Mississauga
www.carters.ca www.charitylaw.ca www.antiterrorismlaw.ca