THE 2007 ANNUAL
CHURCH & CHARITY LAW™ SEMINAR

Toronto – November 7, 2007

New and Unusual Gifts for Churches & Charities

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New and Unusual Gifts for Churches & Charities

Recent Developments in the Law

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INTRODUCTION

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

OUTLINE

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

1. PRIVATE COMPANY SHARES

- **Private company shares can be effective gifting tool**
- **However implementation and ongoing management of such gifts more complex/costly**

a) Income Tax Considerations for the Donor

- **Donation tax credit**
  - **Tax incentive for gifts of publicly traded securities not available**
- **Generally no charity receipt if non-qualifying securities**
  - **Exception - shares gifted to charitable organizations/public foundations and donor at arm's length**
  - **Trap – if shares → debt after gift**

- **RDTOH**
  - **Redemption of shares by charity shareholder may → refund of RDTOH**

    So Donor → tax credit

    Company → RDTOH

    Charity → value of shares

- **Deemed FMV**
  - **Draft legislation introduced Feb 27, 2004 - To stop "buy low-donate high" and other tax shelter gifting arrangements**
  - **Potential punitive tax consequences for private company shares gifts (e.g., estate freezes and other corporate reorganizations?)**

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- **Rule:**
  - **Property acquired through a "gifting arrangement", in contemplation of gift or donated within 3 years of acquisition**
  - **Deemed fair market value- lesser of FMV and donor's cost**
  - **Exceptions include publicly traded shares, certified cultural property, real property in Canada, inventory and ecological gifts, and gifts on death.**
  - **Exception for shares subject to estate freeze arrangements**

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b) Income Tax Considerations for the Charity

- **Donation receipt**
  - **Fair market value of shares – what is value if can't redeem for some time**
- **Disbursement quota issues**
  - **Enduring property?**
  - **If hold shares for some time → dividends to cover 3-5% DQ and administrative costs**
- **Control of corporation**

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

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

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

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2. FLOW THROUGH SHARES (FTS)

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

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Example: investor buys FTS

- **ACB $1,000**
- **Deductions of $1,000 for exploration expenses leading to $460 tax savings (assume 46% tax rate)**
- **Donor gifts the shares to charity (other than private foundation)**
- **Assume value is still $1,000**

a) Income Tax Considerations for the Donor

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

b) Income Tax Considerations for the Charity

- **Date of gift considerations**
- **Valuation issues:**
  - **Hold periods**
  - **Maintenance of value**
  - **Marketability of shares after hold period**
- **Policy re. closing bid price or midpoint between high and low trading values**

3. LIMITED PARTNERSHIP INTERESTS

- **Increasing requests to receive gifts of limited partnership interests**
- **Limited partnerships are very different from general partnerships and are usually set up by companies that invest money in other businesses or real estate**

a) Income Tax Considerations for the Donor

- **Donation tax deduction or credit for the FMV of the interest**
- **50% of any capital gain would be included in income and subject to tax, unless a publicly listed security**

b) Income Tax Considerations for Charity

- **CRA Position: The charity would be considered to be carrying on a business if it becomes a limited partner in a partnership and subject to possible revocation**
- **The fact that the principal activity of the partnership is the investment of funds did not change their view**

- **But, consider whether position would be the same if donation consists of limited partnership units which are publicly listed, widely held, and sold immediately upon receipt**

4. INTEREST IN A HEDGE FUND

- **Investment advisers increasingly asking charities to accept gifts of units in a hedge fund and issue tax receipts for them**
- **Hedge funds are a specialized kind of investment. They are usually addressed to sophisticated investors and are privately offered, and thus may escape the regulatory controls placed on investments sold to the public, such as mutual funds**

- **Canadian donors and charities access hedge funds through a number of different forms including managed accounts, pooled funds and derivatives**
- **Retail investors usually hold interests in pooled funds, which are usually structured as limited partnerships or trusts**

a) Income Tax Considerations for the Donor

- **Donation tax deduction or credit for the FMV of the interest**
- **50% of any capital gain would be included in income and subject to tax, unless a publicly listed security**

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b) Income Tax Considerations for the Charity

- **Will depend on the nature of the underlying interest, unit in a limited partnership or a trust**
- **If limited partnership interest, see concerns above**
- **CRA position: The *Income Tax Act* allows charities to accept a gift like an interest in a hedge fund (Registered Charities Newsletter No. 8 — Spring 1999)**

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- **CRA intends to closely examine the valuation of these gifts**
- **Independent, expert appraisals (with access to all relevant facts) must be obtained to determine the FMV of the fund units when the gift is made**
- **Any tax receipt issued should carry the name and address of the appraiser**

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5. ECOLOGICAL GIFT

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

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Example: Donation of a Remainder Interest

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

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

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a) Income Tax Considerations for the Donor

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

- **Immediate donation tax credit in year of gift even though able to continue to use the property**
- **Remainder of the donation may be carried forward for 5 years**
- **No tax on the capital gain arising as a result of the disposition of the remainder interest**

b) Income Tax Considerations for the Charity

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

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