THE OTTAWA REGION
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Basic Tax Considerations in Gift Planning

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BASIC TAX CONSIDERATIONS IN GIFT PLANNING

Ottawa Region Charity & Not for Profit Law Seminar
Wednesday February 16th, 2011

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OVERVIEW OF TOPICS

- Basic treatment of gifts under the *Income Tax Act* ("ITA")
- 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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1. The Basic Treatment Of Gifts Under The *Income Tax Act* ("ITA")

a) What is a gift?

- Traditional common law definition requires:
  - intention to give
  - transfer of property
  - voluntarily; and
  - No consideration or advantage

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The Basic Treatment Of Gifts (Con't)

- Concept of split-receipting
  - first introduced December 20, 2002
  - create new concept of gift for tax purposes to allow split receipting
  - still not law
- However, CRA administratively operates as though the amendments are already in force

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The Basic Treatment Of Gifts (Con't)

b) What is the "eligible amount of gift"?

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

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

- If the donor makes a donation where the advantage exceeds 80% of the FMV of the property and donative intent cannot be shown, the donation will not be considered a gift

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The Basic Treatment Of Gifts (Con't)

c) What is not a gift?

- Pledged amounts which are not received
- Donation of services
- Payment of sponsorship fees
- Loans
- Provision of free use of property
- Donations which are court ordered or otherwise compelled

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

a) Gift by individual
- Non-refundable tax credit of total amount of eligible amounts of any gifts made in the year or 5 preceding years (ss 118.1(3)
- Tax credit up to 75% of donor's income reduces the total tax payable
- 5 year carry forward for amounts in excess of the annual limit

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What Are The Benefits (Con't)

b) Gift by a corporation
- Corporations can deduct up to 75% of net income of total amount of the eligible amounts of any gifts made in the year or 5 preceding years (ss 110.1(1))
- Note deduction is applied to reduce the taxable income of corporation, whereas the tax credit for an individual reduces the tax payable

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What Are The Benefits (Con't)

c) What about gifts to U.S. charities?
- a Canadian donor may claim a charitable 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, Article XXI(6) of the *Canada-United States Income Tax Convention*, 1980
- Credits restricted to 75% of the donors net U.S-source income

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What Are The Benefits (Con't)

d) Gifts in the year of death?
- tax credit on gifts in year of death, including those that the person bequeathed in his or her will
- The amount claimed can be applied against 100% of the person's income for the year
- Unused tax credit can be carried back to 1 year prior to death

3. Gifts In Kind

a) What is a gift in kind?
- Property other than cash, (does not include the provision of services)
  - Includes books, art work or art collections, archival documentation, works or material, equipment, software, or other property except land

Gifts In Kind (Con't)

b) Valuation of gifts in kind
- must be valued at FMV
- If FMV less than $1,000, value can be determined by a member of the charity, or another individual, with sufficient knowledge of the property.
- donor should keep all documents used to determine the FMV
- If FMV greater than $1,000, independent 3rd party appraisal advisable

Deemed Fair Market Value

c) If the “deemed fair market value” rules apply, value of gift will be ground down to cost basis
   i) If property acquired 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
   iii) If the donor acquired the property less than 10 years before making the gift, one of main reasons for the acquisition was to make a gift (donor must prove that the donor did not have an expectation to make a gift when the property was acquired)

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Deemed Fair Market Value (Con’t)

- The deeming provision does not apply to certain gifts
  - inventory, real property or an immovable situated in Canada, certified cultural property, publicly traded shares and ecological gifts
  - gift by will
  - Where a property through to a corporate reorganization
  - Where property acquired on a rollover basis (ex: from a spouse)

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4. Gifts Of Capital Property

- any property that will give rise to a capital gain or loss when disposed of (s. 54)
- 50% of capital gain included in taxable income in year corporate property sold

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Gifts Of Capital Property (Con't)

- Gifts of capital property are deemed to have been disposed of at their FMV
- Permitted to elect any value between the adjusted cost base ("ACB") and FMV to determine the proceeds of disposition and the amount of the gift
- The elected amount cannot be less than the amount of the advantage under subsection 248(32)

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Gifts Of Capital Property (Con't)

b) Special rules for gifts of capital property that are exempted from the capital gains inclusion
   i. Publicly traded shares
   ii. Ecologically sensitive land
   iii. Cultural property

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Gifts of Publicly Traded Shares

- Date of gift
- Certified delivery to and acceptance by charity
  - Certificate delivered
  - Certificate mailed
  - Electronic transfer

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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
- An ecological gift is exempt from capital gains tax
- the recipient of an ecological gift must be an eligible recipient, which if it a registered charity, must be approved by the Minister of the Environment (of which there are approximately 190)

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Gifts of Ecologically Sensitive Land (Con't)

- 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
- The FMV must be certified by the government through the appraisal review panel

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Gifts of Cultural Property

- 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 will determine 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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Gifts of Cultural Property (Con't)

- No capital gain inclusion on gift and may be claimed against up to 100% of taxable 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 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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6. 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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Income Taxation on Death

- Subsection 70(5) of the Income Tax Act deems every individual to have disposed of all of his or her capital property immediately before death for fair market value
  - limited deferral available

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Advantages of Charitable Giving on Death

- a gift made by Will deemed to have been made by the individual immediately before death (118.1(5)) and can be claimed in terminal tax return
- Tax credits can be applied against up to 100% of the individual's income in the year of death and the immediately preceding year (118.1(4))

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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 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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Gifts by Will (Con't)

- Not all of these distributions will constitute "Gifts by Will" for the purposes of subsection 118.1(5) of the Income Tax Act
- Instead, could be either:
  - a gift by the estate or testamentary trust entitled to a regular charitable donation credit pursuant to subsection 118.1(3) of the Income Tax Act (i.e., up to 75% of the income of the estate/trust); or
  - may not be a gift at all (therefore no charitable donation credit) but instead may be a distribution in satisfaction of a charity's income or capital interest in a testamentary trust;

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Gifts by Will (Con't)

- Very little case law on what constitutes a "Gift by Will". Reliance on CRA policy statements which have significantly changed over recent years
- Criteria Considered as to whether a "Gift by Will" qualifies under subsection 118.1(5):
  - Quantum of Gift
  - Form of Property Gifted
  - Recipients of Gift

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Gifts by Will (Con't)

- Trustees can select
  - Form of property
  - Recipients
  - Ok if conditions attached to gift
- Recipient
- If Trustees have the discretion to decide on the quantum of gift, may not be "Gift by Will" for purposes of subsection 118.1(5)
- 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

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Gifts by Will (Con't)

- 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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Gifts by Will (Con't)

If it is not a "Gift by Will" is it either:
- a gift by an estate or testamentary trust;
- or a distribution in satisfaction of the charity's interest as a beneficiary in a testamentary trust?

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Gifts by Will (Con't)

- 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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Life Insurance

- Gift of ownership of existing or new life insurance policy to a charity. Policy may be fully paid-up or premiums may need to be paid
- Charity is designated as the beneficiary of a life insurance policy

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Life insurance (Con't)

- Value of gift of a life insurance policy
  - Previous CRA position (IT-244R3) – cash surrender value of policy
  - Current CRA position (See CRA Technical Interpretation 2008-026709 and Document #2009-0316701C6) – fair market value as determined by a number of factors, including (a) cash surrender value (b) the policy's loan value (c) face value (d) the state of health of the insured and his/her life expectancy (e) conversion privileges (f) other policy terms, such as term riders, double indemnity provisions and (g) replacement value.
  - 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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Life insurance (Con't)

- Designation of Charity as Beneficiary of Insurance Policy
  - Donor can change beneficiary designation at any time
  - No current tax credit available to donor; tax credit on death
  - Potential estate planning tax benefits – minimization of probate tax, capital gains tax

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RRSPs and RRIFs

- Donors can designate a charity as beneficiary of a RRSP or RRIF on the death of the donor
  - tax credit in year of death with one-year carry-back
  - Estate planning benefits – minimization of probate tax
- Donors can make a bequest in their Will that the value of the RRSP or RRIF proceeds be given to charity
  - Loss of probate tax planning benefits as RRSP or RRIF proceeds will fall into the estate for probate tax planning purposes

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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 ie: no right to encroach on capital
- The recipient charity can issue an official donation receipt for the fair market value of the residual interest at the time that the residual interest vests in the charity provided that a number of requirements are met
- The fair market value of the residual interest is a complex valuation exercise – professional assistance most likely required
- IT 226R

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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

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Private Company Shares (Con't)

Criteria

- the security must be in the form of a share;
- the charity receiving the gift is a charitable organization or a public foundation, as opposed to a private 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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Other Issues to Consider When Dealing with Private Company Shares

- Complex valuation issues – what is value of charitable receipt?
- Are the deemed fair market value 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 (only for Private Foundations)?
- Is the retention of the shares a prudent investment of the charity for trust law purposes?

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Flow Through Shares

- Tax based financing incentives (oil and gas/mining sectors)
- Corporations can flow through tax deductions to the investor; expenditures deducted by the investor reduces the cost base of shares
- Very positive tax incentives for the donor
- Valuation issues for the charity: (i) maintenance of value; (ii) marketability of shares; etc.

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Flow Through Shares (Con't)

- Example:
  - Investor buys flow through shares with ACB: $1000
  - Deducts $1000 for exploration expenses leading to $460 tax savings (assuming 46% tax rate)
  - Donor gifts shares to charity (assume value is still $1000)
  - Tax deduction during hold period of $460
  - Donation tax credit leads to tax savings of $460 and no tax on the gain arising from the gift of shares to the charity
  - Actual cost to the taxpayer of the investment is $80 ($1000 less $460 x 2)

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Resource materials

- Canada Revenue Agency
  - P113(E) Rev. 09 Gifts and Income Tax Act - online: http://www.cra-arc.gc.ca/E/pub/tg/p113/p113-e.html
- M.E Hoffstein, Theresa L.M. Man and Laura West, “Where is an advantage not an advantage – Issues Arising from the Proposed Split-receipting Regime” online: http://www.carters.ca/pub/article/charity/2006/mehtlmlew0511.pdf
- Terrance Carter, “Tax Credits and Capital Gains Strategies” online at: http://www.carters.ca/pub/article/charity/2009/tsc0418a.pdf and http://www.carters.ca/pub/article/charity/2009/tsc0418b.pdf

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