CARTERS
BARRISTERS
SOLICITORS
TRADEMARK AGENTS

CHARITY & NFP LAW BULLETIN NO. 386

MAY 26, 2016

EDITOR: TERRANCE S. CARTER

TESTAMENTARY CHARITABLE GIVING: THE NEW REGIME (REVISED)

EDITOR'S NOTE: This Bulletin is an update of our *Charity & NFP Law Bulletin* No. 380 that was previously posted on February 25, 2016, and reflects changes introduced by the 2016 Federal Budget**.**

By M. Elena Hoffstein – Guest Contributor*

A. INTRODUCTION

On December 16, 2014, Bill C-43 received Royal Assent. The new rules introduced by the Bill affect the manner in which testamentary trusts are taxed and, in addition, change significantly the manner in which testamentary charitable gifts will be dealt with under the *Income Tax Act*, RSC 1985, c.1 (5th Supp.) ("ITA").

B. BACKGROUND

In order to better appreciate the significance of the changes and their impact on testamentary charitable giving, it is important to review briefly the law as it was prior to 2016.

In the past, income and capital gains retained in *inter vivos* trusts were taxed at a different rate than testamentary trusts. *Inter vivos* trusts have always been taxed at the top marginal rates of tax. On the other hand, testamentary trusts and certain pre-1971 *inter vivos* trusts have enjoyed access to progressive rates

* M. Elena Hoffstein, as our guest contributor, is a partner with the national firm of Fasken Martineau and is engaged in personal tax and estate planning, family business succession planning, wills and trusts, corporate reorganizations, marriage contracts and charities and not for profit law. Ms. Hoffstein has been ranked by Lexpert as one of the most frequently recommended Toronto private client and charity law practitioners and as one of the top 500 lawyers in Canada. Martindale-Hubbell has given her a rating of AV. In 2006, she received the Ontario Bar Association Award of Excellence in Trusts and Estates in recognition of her leadership and contribution to estates and trusts law. She is also a recipient of Lexpert's prestigious Zenith award for business law and business of law. Ms. Hoffstein may be reached at (416) 865-4388 or ehoffstein@fasken.com.

of tax and other benefits not available to *inter vivos* trusts. Bill C-43 has eliminated the various differences between *inter vivos* and testamentary trusts commencing in 2016. There are two exceptions to these new rules. Firstly, the progressive tax rates will continue to apply to the first thirty-six (36) months of an estate that arises as a consequence of the death of an individual and that is a testamentary trust. This type of trust has been given a new name, the graduated rate estate or GRE, as it is now affectionately named. The second exception is for trusts that qualify as qualified disability trusts or QDTs for disabled individuals. It is not intended to discuss QDTs in this *Bulletin*.

C. GRE: WHAT IS IT?

A GRE is defined as an estate that arose on and as a consequence of the death[1] of an individual if (i) the estate is at that time a testamentary trust as that term is defined in the ITA[2]: (ii) the estate designates itself as a GRE in its tax return for the first taxation year ending after 2015: (iii) no other estate has designated itself as a GRE of the deceased individual; and (iv) the deceased's social insurance number is provided. In addition, it is provided that a GRE can only last as such for up to thirty-six (36) months after the date of death of the individual. There is a deemed year end at the termination of the 36 month anniversary of death and the estate will have a December 31 year end thereafter. This timeline appears to be inflexible as there is no provision as in other sections of the ITA for an extension of time on written application to the Minister of National Revenue (such as ss. 70(6)). Thus, it is important to note that if there is planning that relies on GRE status it must occur within this time period.

D. WHAT ARE THE BENEFITS OF BEING A GRE?

The benefits that are available for a GRE and not for other testamentary trusts include the following.

- the graduated tax rates applicable to individuals will apply to income retained in the GRE[3];
- a GRE can continue to have an off-calendar year;
- a GRE will be exempt from remitting tax instalments and will only be required to pay Part I Tax within 90 days after the end of its taxation year[4];
- a basic exemption from Alternative Minimum Tax of $40,000 will be available to the GRE[5];

[1] ss. 248(8) of the Income Tax Act, (Canada) defines "occurrence as a consequence of death".
[2] ss. 108(1) Income Tax Act (Canada) defines a testamentary trust. See Appendix A. It is noted that loans or contributions to an estate by a non-arm's length person can cause the estate to lose its status as a testamentary trust and thus cease to qualify as a GRE.
[3] s. 117(2).
[4] ss 104(23)(e) and 156.1(2)(c).
[5] s. 127.51.

- it will be able to allocate out to beneficiaries certain pension benefits, deferred profit sharing plan payments, death benefits, and investment tax credits[6];
- availability of 164(6.1) election for employee stock options included in income under ss. 7(1)(e) and disposed of after death at a loss;
- it will be able to access new flexible rules for donations by will or estate;
- nil capital gains on donations of public securities;
- it will have an extended period for refunds beyond the normal reassessment period[7], and an extended objection deadline[8];
- relief from the application of the stop-loss rules. This will allow for certain post mortem planning using loss carrybacks to avoid double taxation when the assets of a deceased include private company shares[9];
- it will be exempt from Part XII.2 tax on distributions in respect of certain Canadian-sourced income to non-residents and in certain circumstances to tax exempt entities; and
- it will be entitled to carry capital losses back to the deceased's terminal year under subsection 164(6) of the Act. This provision has traditionally been utilized to minimize double tax that can arise on the death of an individual where shares of a private corporation are redeemed by the estate. This will now only be available to the GRE's and not to other testamentary trusts. See also availability of ss. 112(3.2) planning now available only for GREs.

There is no grandfathering for existing trusts which will have a deemed year-end on December 31, 2015. Thus, for those testamentary trusts which have had a fiscal period or off-calendar year-end, this will result in two year-ends in 2015.

An exception is provided in ss. 249(4.1) if the particular trust is an estate which exists at the end of 2015 and that is a GRE of the individual for the first 2016 taxation year. In this case, and in the case where the particular trust is an estate that arose on a death after 2015, and that is a GRE for its first taxation year that deemed taxation year end is deferred until the last time at which the estate is a GRE (thirty six (36) months after the death of the testator) if it elects to be a GRE in its first tax return filed after December 31, 2015.

[6] ss 104(27), 104(27.1), 104(28) and 127(7).
[7] ss 152(3.1) and 152(4.2).
[8] ss 165(1)(a).
[9] ss 112(3.2)(a)(iii).

As was noted above, a GRE can only qualify as such for a maximum of thirty six (36) months after the death of an individual. At the end of the (thirty six (36) month period, the estate realizes a taxation year end and the GRE status is lost[10]. It is important, therefore, that if there is planning that relies on GRE status, it must occur within this time period.

A number of preliminary questions have arisen with respect to the GRE. One of the pre-requisites for a GRE, as noted above, is that only one estate can qualify as a GRE. In situations where multiple wills are used to avoid probate tax, the question has arisen as to whether this creates two estates or just one. It would appear that the profession has approached this issue in two ways. There are those who see multiple wills as creating two estates. Others believe that there is only one estate even in cases where there may be different executors of the two estates. CRA has indicated that, in its view, there is only one estate[11] and that, therefore, a combined tax return should be filed and joint election made to designate the estates as a GRE. In situations where there are different executors of multiple estates it may be prudent to draft provisions in wills to address this matter[12]. These provisions could provide who is to file the GRE designation, how GRE status is to be determined and what is to happen to income/capital during the term of the GRE administration.

It is also important to note that only an estate can qualify as a GRE. What then is an estate? An estate arises on the death of an individual and continues until the executors are in a position to distribute the assets to beneficiaries outright or to on-going trusts which may continue for some time[13]. Testamentary trusts established under a deceased person's will do not qualify for GRE status, nor do life insurance testamentary trusts, even if established under the will of a deceased individual.

As noted in the Explanatory Notes to Bill C-43 (October 23, 2014 and October 30, 2014):

> In the case where an individual's will provides for the creation of a trust from all or part of the property of the individual's estate, the property may be considered property of the estate until the estate transfers or distributes the property to the trust

[10] ss 249(4.1).
[11] CRA Views 2010-0358461ES and 2015-057209166 spousal trusts and see explanatory notes under definition of GRE in ss. 248(1) ITA.
[12] See also 104(2) which may assist.
[13] CRA has noted that it considers a testamentary trust to be terminated at the time indicated on the clearance certificate and therefore executors may wish to delay requesting a clearance certificate until they are in a position to distribute the funds to prevent CRA from considering an estate to be settled before assets are distributed. Documenting executors vs. trustee decisions will also be an important consideration. While in many cases it will be advisable to keep the GRE status until the thirty six (36) month limit, it is also important to consider other provisions of the Income Tax Act. For example if the will sets up a spousal trust, one of the prerequisites to a roll in of property to a spousal trust is that the property must vest in the spousal trust within thirty six (36) months of death.

> or the duties of the personal representative in administering the estate are complete. In some cases, however, property in separate trusts created under the terms of an instrument, such as a will, will not form part of an individual's estate for income tax purposes. For example, a particular individual's estate does not include a trust created under the terms of another individual's will, such as, for example, a spouse or common-law partner trust described in paragraph 70(6)(b) of the Act for the benefit of the particular individual.

As noted above, in order to continue to qualify as a GRE, the estate must meet the requirements of a testamentary trust.[14] Therefore it cannot receive contributions from an individual other than from an individual on his or her death, or receive loans from or incur indebtedness to a beneficiary or a person dealing at non-arm's length with a beneficiary.

Okay, so now we know what a GRE is. How does this affect testamentary charitable gifting?

In order to understand the significance of the changes that Bill C-43 brought about to the testamentary gifting on death rules, it is important to know what the rules were pre-2016.

For pre-2016 deaths, the ITA provided that a charitable gift made by will (often referred to as a "Gift by Will") was deemed to have been made by the donor immediately prior to death. This was advantageous because it ensured that the donation tax credits arising from the gift could be used in the deceased's terminal return to offset tax liability arising from the deemed disposition of his or her capital assets immediately prior to death. To the extent that these donation tax credits were not exhausted in the donor's terminal return, a one-year carry-back of the credits to the year preceding the year of death was permitted. In addition, the credits could be applied against 100% of the income in these years (not 75% as is the usual rule).

Canada Revenue Agency has issued many publications outlining its position as to what constitutes a "Gift by Will", and in general, requires that: (i) 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; (ii) it is clear from the terms of the Will that the executors are required to make the donation; (iii) the estate is in a position to make the donation after the payment of debts; and (iv) the donation is actually made.

Under these rules, the value of a Gift by Will for charitable receipting purposes was to be determined on the date of the individual's death regardless of when the charity actually received property from the estate.

---

[14] s. 108(1) of the ITA

If a gift did not qualify as a "Gift by Will", it could qualify as a charitable gift made by an estate or testamentary trust. In other cases, a distribution made to a charity from a testamentary trust would not be considered a charitable gift eligible for a donation tax credit, but instead would be considered a distribution made in satisfaction of the charity's capital interest in the testamentary trust and no donation tax credit would be available.

Donation tax credits were also available when a charity was designated as beneficiary under a life insurance policy, registered retirement savings plan (RRSP), registered retirement income fund (RRIF) or tax free savings account (TFSA).

E. THE NEW REGIME

The new legislation introduces significant changes to this testamentary charitable gift regime for the 2016 and subsequent taxation years, both as to timing and recognition of charitable gifts for tax purposes.

With respect to deaths after January 1, 2016, donations made by will and designated donations (RRSP, RRIF, TFSA and life insurance) will be deemed to be made by the estate at the time when the property is transferred to a charity and no longer will be considered to have been made immediately before the donor's death.

As well, the fair market value ("FMV") of the gift for tax receipting purposes is to be determined at the time of the transfer of property rather than the FMV at the date of death.

The legislation builds some new flexibility into the ability to use the donation tax credits in respect of estate gifts by will and designated donations by permitting the executors or trustees of a GRE to allocate the tax credits among:

- the terminal or last taxation year of the donor;
- the taxation year preceding the taxation year of death; and
- the taxation year of the Estate in which the donation is made and up to two (2) prior years of the estate.

It is only a GRE, however, that enjoys the benefits of the flexibility to allocate the donation tax credit among different tax years and, most importantly, to carry-back the donation tax credit to the year of death and one year prior to death, which in many cases is where the largest tax liability arises (because of the deemed disposition on death rules). Thus, if an estate is to benefit from this flexibility, it is important that

the estate attains and maintains GRE status and that the property be transferred to charity within thirty-six (36) months after death.

An additional requirement is that the property to be transferred to the charity by the GRE must be property held by the deceased at date of death or property substituted therefor. This rule is important to keep in mind when contemplating post mortem reorganizations in circumstances where charitable gifting is also involved as the property to be gifted after such a reorganization may not be property owned by the deceased at the date of death or property substituted therefor. For example dividends declared on shares owned by the deceased with the intent that they be used to fund a charitable gift would not qualify. In addition, it is important to note that a borrowing of funds by an estate to effect a charitable gift within the thirty-six (36) months will also not qualify for the flexible rules allowing use of the donation tax credit in the year of death or the year before the year of death.

Current annual charitable donation limits of 100% of net income for the donor’s last taxation year or for the taxation year preceding the taxation year of death will continue to apply.

An estate other than a GRE will continue to be able to claim the charitable donation tax credit in respect of other donations in the year in which the donations are made or in any of the five following years.

It is also noted that the rules relating to the tax free transfer of publicly traded securities to charity will now be limited to gifts of publicly traded securities made by the GRE.

F. ANY OTHER CHANGES?

The new rules appear to provide more flexibility for testamentary charitable gift planning but that flexibility comes at a price.

It will allow executors to claim donation tax credits for testamentary charitable gifts for five different tax periods (the year prior to death, the year of death, and three (3) years of the estate) as opposed to just two tax periods (the year prior to death and the year of death). It will also create more flexibility by apparently eliminating the need for testamentary donations to qualify as “Gift by Wills” so long as the transfer of property to the charity takes place within thirty-six (36) months of death.

The new rules also provide certainty as to when to value testamentary charitable gifts for charitable receipting purposes – namely, upon the date of receipt of property by the charity. This should eliminate the current divergence of positions taken by charities as to whether the value of the donation tax receipt

is the value of the donated property on the date of death of an individual or the value of the donated property at the time the charity receives the donated property.

Although this flexibility and clarity is in large part welcome, it will provide extra pressures on executors of estates. Executors will need to ensure that estate property is transferred to charities within thirty-six (36) months after death in order to qualify for the ability to allocate donation tax credits in the year of death or the year prior to death. This thirty-six (36) month period may be difficult to meet if (i) the estate is involved in litigation (*Family Law Act* claims, dependent relief claims, will challenges); (ii) the estate's assets are illiquid (real estate, private company shares), (iii) the donation is made after the death of a life tenant (under current rules such gifts would be claimed in the year of death if the life estate qualified as a charitable remainder trust (no right to encroach on capital during life tenant's lifetime)). Moreover, even in ordinary circumstances, if the value of estate property increases or decreases following death, then depending upon the tax outcomes, executors could be criticized for either moving too quickly or waiting too long to transfer property to charities within the thirty-six (36) month period.

As was noted earlier there is no provision for ministerial discretion to extend the time.

G. DRAFT LEGISLATION JANUARY 2016

It appears, however, that there has been some sympathy for the tight timeframe imposed by the thirty-six (36) month timeline. As a result of submissions made by various interest groups commenting on the challenges posed by thirty-six (36) month period, draft legislation tabled January 15, 2016, introduced a proposal to extend the thirty-six (36) month period to sixty (60) months after the death of an individual. These proposals provide that an estate donation made by a former GRE after it ceases to have this status because of the expiry of thirty-six (36) months (but which otherwise qualifies) and before the end of sixty (60) months after the date of death can be claimed in the year in which the transfer is made to the charity, in the year of death and the year prior to death.

As will be noted, while there is flexibility in permitting the allocation of the donation tax credit to the year of death and the year prior to the year of death, the rules relating to gifts made during the GRE thirty-six (36) month period had greater flexibility in permitting the allocation of the donation tax credit over prior years of the estate as well.

Some interest groups have already commented that they would like the flexibility afforded GRE gifting to be extended to transfers to charity during the period from thirty-six (36) months to sixty (60) months,

such that even if the transfer to charity occurs between the 36th and 60th month after death, the estate be permitted to allocate the donation tax credit among the year of the transfer, all prior years of the estate, the year of death and the year prior to death. This would permit the donation tax credit to be applied in prior years of the estate where taxable income may have arisen due to, among other things, post mortem planning (which often occurs to avoid double tax situations especially where assets are held in private companies).

H. SOME UNRESOLVED ISSUES

1. Charitable remainder trusts

The new regime does not appear to specifically deal with the treatment of gifts to a charity on the death of an intervening life interest. Under the old gift by will rules, if an individual left a life interest to, for example, a spouse and then provided that on the death of the spouse a charity receive the remainder, the gift to the charity would qualify as a gift by will so long as the trustees had no right to encroach on the capital in favour of the life tenant during the lifetime of the life tenant (a charitable remainder trust).

The new rules contemplate that the property that is the subject of a testamentary charitable gift must be transferred to a qualified donee within thirty-six (36) months of death. While a residual interest in a charitable remainder trust is a property interest that can be transferred to a qualified donee within thirty-six (36) months of death, it is only that property interest and not the actual underlying property of the charitable remainder trust that can be transferred prior to the death of the life tenant. As a result, there remain some questions as to manner in which testamentary charitable remainder trusts will be dealt with under the new rules.

It is noted that if a charitable remainder trust is created *inter vivos* (that is to say a trust is established, for example, for a spouse during the lifetime of the spouse with no right to encroach on the capital and the trust provides that on the spouse's death the trust assets are distributed to charity) the residual gift to charity would qualify for immediate donation tax credit to the person who contributed the property to such a trust at the time the trust was created. There are many types of charitable remainder trusts that can be created yet because of the current tax rules not all are eligible for donation tax credit relief notwithstanding the charitable intent of the settlors/testators. This would appear to be an area where more discussion is warranted and submissions have already been made by organizations such as the Canadian Association of Gift Planners ("CAGP").

2. <u>Issues involving testamentary Gifts of private company shares/non-qualifying security/excepted gift</u>

In addition, it would appear that there are unintended consequences to the new rule that it is not the deceased but rather the estate of the deceased (whether the estate generally or the GRE) which is now considered the donor of the gift. This relates to gifts of private company shares to public foundations or charitable organizations.

Under the prior rules, a testamentary gift of private company shares to either a public foundation or charitable organization (but not to a private foundation in order to avoid the excess corporate holdings rules) and that qualified as a gift by will would give rise to an immediate donation tax credit that could be applied to offset income in the year of death or the year prior to death.

Under the new rules, such a gift would be treated as a non-qualifying security. A brief explanation is needed before returning to the problem created by the new testamentary charitable gifting rules as they apply to gifts of private company shares.

A non-qualifying security is defined in subsection 118.1(18) of the ITA as a share or debt of a private company with which an individual or estate does not deal at arm's length immediately after the relevant time (which in our case would be the time of the gift). Gifts of private company shares by an individual who controls the company are caught by the definition as are gifts of debt by in individual within the debt is in respect of a non-arm's length corporation. If a donation of a non-qualifying security is made, the donor will be denied a tax credit for the donation in the year in which the gift is made. That is, the gift is ignored for the purpose of the charitable donation tax credit. However if the non-arm's length connection between the donor and the issuer of the security is broken within the first sixty (60) months or the recipient charity disposes of the security within sixty (60) months of the time the donation is made, the gift will be deemed to have been made at the time the non-qualifying security is disposed of or ceases to be non-qualifying. The charity can then issue a donation receipt for the gift.

There are certain gifts of shares that do not fall within the definition of a non-qualifying security. These are called excepted gifts. A gift that is an excepted gift will not be subject to the restrictive rules applicable to a non-qualifying security, but rather tax relief will apply in the usual way. An excepted gift is a gift of shares made to a charity that is not a private foundation (i.e., to a public foundation or charitable organization) with the proviso that the donor deals at arm's length with the donee charity and with each director, trustee or officer of the donee charity. It is noted that this exception applies only to shares not listed on a prescribed stock exchange and it does not apply to gifts of debt.

So this is the rule with respect to *inter vivos* gifts of private company shares and was also the rule with respect to gifts by will.

However, under the new rules, as noted above, such a gift of private company shares, even if made to a public foundation or charitable organization would not qualify as an excepted gift and would therefore be a non-qualifying security.

The reason for this is that a testamentary trust is deemed not to deal at arm's length with a person that is beneficially interested in the trust,[15] including a public foundation or charitable organization such that, as noted above, a testamentary gift to such charity would not qualify as an excepted gift. No receipt could therefore be issued and no donation tax credit would be usable until such time as the private company shares are liquidated and this has to occur within sixty (60) months if the extension to the GRE becomes law, or thirty-six (36) months if it is desired to have the donation tax credit available not only in the year of death and prior year but also during the three (3) years of the GRE.

The natural question that arises is why there is a difference in tax treatment between *inter vivos* gifts and testamentary gifts of private company shares. Submissions have been made to the Department of Finance by the Canadian Association of Gift Planners that the simplest way to resolve this difference in tax treatment is to make testamentary gifts of private company shares to public foundations and charitable organizations an excepted gift.

I. NEW LIFE INTEREST TRUST RULES (SS 104(13.4))

New rules that became effective January 1, 2016 apply to life interest trusts where there is a deemed disposition on the death of the life interest beneficiary. Life interest trusts are trusts that are (i) spouse/common-law partner trusts that are established *inter vivos* or on death (testamentary); (ii) alter-ego trusts; (iii) joint spouse/common-law partner trusts; and (iv) self-benefit trusts. The common elements to these trusts are that the assets can be transferred to such trusts on a roll-over or tax deferred basis. On the death of the life tenant beneficiary there is a deemed disposition and tax is exigible on any accrued gains. Until 2016, any tax arising on the death of the life tenant would be taxed in the trust.

The new rules, effective January 2016, provide that on the death of the life-interest beneficiary (or on the death of the survivor of the life tenants in the case of joint partner trusts) there is a deemed year-end for the trust, the gain on the deemed disposition and all income for that year is deemed payable to and included

[15] See question 12 STEP Round Table 2015

in life interest beneficiary's income. That is to say, the estate of the life tenant becomes liable for the tax arising in the trust. There is no grandfathering of existing trusts. While it was stated that there is a joint and several liability for the trust and the life interest beneficiary estate, there were many issues identified by the estates and trust and charitable sector. These included an unfair tax burden on the beneficiaries of the estate or the life tenant who were shouldering the tax burden without the benefit of owning the assets to which such tax burden applied (as the assets remained in the trust). In addition planning, which was anticipated to take place on the death of the life tenant to avoid double tax situations was frustrated.

In response to such concerns, on November 16, 2015 a "Comfort Letter" was released from the Department of Finance and on January 15 draft legislation followed. These initiatives responded on two concerns:

- misplaced tax liability; the new provision caused the tax liability from the deemed disposition of the trust assets and trust income in the year of the (life interest) beneficiary to be taxed in the hands of the deceased life tenant's estate, not the trust,
- the stranding of donation tax credits with respect to charitable donations made by the trust after the death of the (life interest) beneficiary.

The proposed new rules would return to what was the status quo prior to January 1, 2016[16]. Thus, it is proposed that gains on deemed dispositions occurring on the death of the life tenant will continue to be taxed in the life interest trust and not in the life tenant's estate. The proposed new rule also provides that, in limited circumstances, there will be an opportunity to elect to tax the gain in the life tenant's estate, but this will only apply to post-1971 testamentary spouse or common-law partner trusts created by the Will of a taxpayer who died before 2017 with a Canadian resident beneficiary.

With respect to charitable gifting, under the January 2016 draft legislation if the life interest trust makes a gift within ninety (90) days after the end of the calendar year in which the beneficiary spouse dies (the filing due date), it can allocate the charitable tax credit to the short taxation year of the trust that resulted from the beneficiary spouse's death or alternatively in the year of the gift or the following five (5) years. This will allow for the matching of tax liabilities and charitable credits.

[16] i.e. 104(13.4)(b.1) – 104(13.4)(b) will no longer apply.

It is noted that in order to achieve this result the property transferred to charity must be property owned by the trust on the date of death of the life interest beneficiary or property substituted therefor. Thus dividends paid on shares held by the trust on the death of the life tenant could not be used to make the charitable gift as the dividends would not qualify as property held on the death of the life tenant or property substitution therefor. If shares of a corporation are redeemed the cash share qualify as property substituted therefor.

In addition, in order to qualify as a donation by the trust (as opposed to a distribution to a charity as a beneficiary) the terms of the trust must give the trustees the ability to make or not make the charitable donation (i.e. the charity must not be receiving the gift as a beneficiary of the trust but as a charity recipient of a charitable gift). This is because to qualify as a gift it must be voluntary, hence the need for the trustees to have the ability to make or not make the gift[17] .

These proposals, while welcome, only partly address the issue of stranded donation tax credits after the death of a life tenant of a life interest trust. Firstly, the "gift" may not qualify as such based on the CRA interpretation of what constitutes a "gift". There may also be timing issues depending on when the life tenant dies. If the death occurs close to the end of the calendar year, there will only be a short time before the tax return has to be filed (ex. a December death allows only a three (3) month window (to March 31 of the following year). A death earlier in the year could provide more time to effect the charitable gift.

J. 2015 FEDERAL BUDGET AND 2016 FEDERAL BUDGET

1. Donations Involving Cash Proceeds of Private Corporation Shares or Real Estate

   Budget 2015 (tabled April 21, 2015, draft legislation introduced July 31, 2015) introduced proposals to provide an exemption from capital gains tax in respect of certain dispositions of private corporation shares and real estate. Prior to these proposals, a donor would be entitled to a charitable donation credit (or deduction for a corporate donor) for donations of capital property to a qualified donee (such as a registered charity, RCAAA and other qualified entities). However, such donations also gave rise to capital gains in the hands of a donor thus giving rise to tax. The capital gains tax payable would be reduced or eliminated by the donation tax credits or deductions but the overall tax benefit of the gift would be reduced.

[17] For charitable donation planning on the death of a life tenant see Tax Rulings - 2009-035049, 2009-0308611R3, 2008-029212, 2007-022136 and 2004-006027.

Under the Budget proposals in the case of private company shares and real estate, the exemption would be available where:

- cash proceeds from the sale of the private company shares or real estate are donated to a qualified donee within thirty (30) days after the disposition;
- the private company shares or real estate must be sold to a purchaser who is at arm's length to the donor and to the qualified donee to which the cash proceeds are donated.

Regrettably, the 2016 Federal Budget announced that the government does not intend to pursue these proposals.

Gifts of ecologically sensitive land and cultural property, as well as gifts of publicly-traded securities, are unaffected by this measure and will continue to be exempt from capital gains tax gifted to charity.

The proposed rules in the 2015 Federal Budget had been a form of relief that members of the charitable sector had been advocating for, for quite some time. It was acknowledged at the time the proposed rules were announced that they raised practical challenges and implementation issues. Notwithstanding this, the announcement in the 2016 Federal Budget is disappointing as it continues the regime of more favourable tax treatment for certain kinds of donated property over others.

2. Acquisition or Holding of Charities in Limited Partnerships

The 2015 Federal Budget proposed to permit charities to invest in limited partnerships, subject to certain restrictions. This would allow charities to diversify their investment portfolios to better support their charitable purposes and would give charities the flexibility to use more innovative approaches to address pressing social and economic needs in Canada. The 2016 Federal Budget confirms the Government's intention to proceed with the tax measures relating to the acquisition or holding of limited partnership interests by registered charities, but notes that modifications might be made based on consultations held since the original announcement of this measure. We will need to wait and see whether any modifications will be made to this measure. It should also be noted that the CRA announced at the end of December 2015 that Canadian registered charities will now be required to report their limited partnership holdings in their T3010, Registered Charity Information Returns.

3. Commitment to Clarify the Rules Governing Political Activities

The 2016 Federal Budget confirms the CRA's commitment, in consultation with the Department of Finance, to engage with charities, through discussions with stakeholder groups and an online consultation, to clarify the rules governing their political activities. This announcement is consistent with the mandate letter of November 2015 to the Minister of Finance to "work with the Minister of National Revenue to allow charities to do their work on behalf of Canadians free from political harassment, and modernize the rules governing the charitable and not-for-profit sectors". This announcement also follows the completion of the CRA's formal audit program, which targeted the political activities of charities.

While clarification of the rules remains to be seen, in the interim, charities should continue to be aware of and follow the current rules applicable to their engaging in political activities.

4. Charitable Donation Tax Credit Rate

In December, 2015, the Federal Government announced that, effective for the 2016 and subsequent taxation years, there would be an increase in the personal income tax rate on individual taxable income in excess of $200,000 to 33%. One of the consequential proposals in the 2016 Budget is to provide a 33% charitable donation tax credit (on donations in excess of $200) to all taxpayers with income subject to the new 33% rate including trusts that are subject to the 33% rate on all of their taxable income. The charitable donation tax credit measure will be limited to donations made after the 2015 taxation year. This measure will also extend the proposed 33% charitable donation tax credit to donations made by a graduated rate estate during a taxation year of the estate that straddles 2015 and 2016.

The adjustments to the donation tax credit to reflect the increased rate of tax has not been mirrored in all of the provinces however. In New Brunswick, Ontario, Quebec and Yukon the top tax credit rate on donations is less than the top personal income tax rate. Thus the cost of charitable giving for a resident to these provinces in the highest tax brackets will be higher than for donors in other provinces.

This may result in a disincentive to giving. Interestingly, in Alberta the top tax credit rate on donations is higher than the top personal income tax rate[18].

Carters Professional Corporation / Société professionnelle Carters
Barristers · Solicitors · Trade-mark Agents / Avocats et agents de marques de commerce
www.carters.ca **www.charitylaw.ca** **www.antiterrorismlaw.ca**
Ottawa · Toronto
Mississauga · Orangeville
Toll Free: 1-877-942-0001

DISCLAIMER: This is a summary of current legal issues provided as an information service by Carters Professional Corporation. It is current only as of the date of the summary and does not reflect subsequent changes in the law. The summary is distributed with the understanding that it does not constitute legal advice or establish a solicitor/client relationship by way of any information contained herein. The contents are intended for general information purposes only and under no circumstances can be relied upon for legal decision-making. Readers are advised to consult with a qualified lawyer and obtain a written opinion concerning the specifics of their particular situation. © 2016 Carters Professional Corporation

00090270.DOCX

[18] See comparison tables by Brenda Lee Kennedy in Canadian Tax Highlights Vol 24, #4, Apr 2016.