The JCF Canadian Gift Planning Handbook

Robert A. Kleinman FCA

Taking care of tomorrow... today
The Jewish Community Foundation of Montreal

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Author's Forward

Dear Friend,

It has been over three years that I switched careers from being a tax partner with Zittrer Siblin Ernst & Young to becoming the Executive Director of the Jewish Community Foundation of Montreal.
Working as a Jewish community professional is not easy; but it is surely rewarding. Tzedakah is a great profession. Like us all, I was schooled in Tzedakah from family - my grandmother Sarah Klinger Z'L holding out the Blue Box for us, my parents Harry & Yetta Kleinman doing work for Talmud Torahs, my aunt Miriam Peletz a Hadassah macher, my brother Josh and his wife Rowena settling in Vancouver and immediately integrating themselves with the Federation, the Synagogue and Hadassah. My buddies Norman Jaskolka and Michael Millman have been with me always. I thank you all for my education.

I would like to thank Ted Zacks, Shelly Maerov and Lucille Barker of the Council of Jewish Federations and Orly Buzelan, the Executive Director of the Ottawa Jewish Community Foundation for their support, ideas, editing and encouragement without which the Handbook would not have been published.

I have been privileged to work with the best who have supported me in my career change and my development - Marvin Corber, F.C.A., Steven Ain, Harvey & Alta Levenson, Marlene Brand, Steven Drysdale, Robert & Rhoda Vineberg, Danyael Cantor, Stanley Hyman, Michael Blumenstein, Boris Levine, F.C.A., Yoine Goldstein, Maxyne Finkelstein, Harvey Wolfe, Marlene Gerson, Rabbi Sydney Shoham, Arna Poupko, Stanley Plotnick, Robert Raich, Hélène Pinto, Boris Stein, F.C.A. and more, many more. Thank you.

This Handbook is dedicated to three people, a community worker, a fundraiser and a philanthropist.
My wife Alice Herscovitch is a very special, beautiful person. She is Executive Director of Project Genesis, a charity dealing with poverty on the streets of Montreal. She cares so much. You couldn't find a better role model for our children Valerie and Brahm. The best investment return one can find today is allowing professionals like Alice to carry out the Tzedakah that our donated dollars make happen.

Gordon N. Schwartz passed away suddenly and tragically on December 28, 1997. With Marvin Corber, Gordy hired me for the Foundation and I was privileged to work with Gordy during his Presidency of the Foundation from 1995-1997. Gordy loved and worked for the Jewish people. The consummate fundraiser, he brought a smile to everybody. We will miss him enormously.

Alexander Dworkin spent most of his life building one of the most successful dress manufacturing businesses in Canada. Presently, he is devoting his efforts to philanthropy and he has allowed me to become a trusted advisor for which I am very grateful.

I hope that this Handbook will be used to create Tzedakah in your community and I wish you luck in your endeavours. As this Handbook is loose-leaf, we will continually be updating it. If you are aware of innovative gift planning ideas, we will happily add them to the Handbook.

Robert A. Kleinman, FCA — January 2, 1998

1 Introduction to Gift Planning in Canada

Charitable giving has long been a vital part of our social and economic system. To encourage philanthropy, the federal and provincial income tax laws have granted favoured tax treatment for charitable gifts.

The humanitarian aspects of private philanthropy have traditionally been its primary motivating force. The tax benefits resulting from charitable giving, however, have assumed increasing importance as our tax system has grown in complexity and scope. To ensure the greatest possible tax advantage when making charitable contributions, it is extremely important to be aware of the impact of the individual's tax bracket, the form of the gift, and the timing of the gift.

The term "planned giving" connotes the act of charitable giving in a thought out, planned manner which presumably considers the particular attributes and desires of the donor. In the parlance of modern marketing theory, it attempts to exploit "the market of one" for charitable purposes.

As Canadians, we are able to view the American experience in planned giving with some envy, as it appears that many American charities have not only created particular tax and financially efficient planned giving products, but have succeeded in increasing their charitable receipts by using these methods. Terms such as deferred charitable gift annuity, pooled income fund, charitable remainder unitrust, grantor lead unitrust and others have become part of the lexicon of charitable giving and to a certain extent American society. The success is due to a number of factors including a tax system which is more benevolent to charities than the Canadian system. However, what is sure is that American charities have taken advantage of the tax benefits by understanding the needs of the consumer, the donor, and creating product and mechanism to fit those needs.

Canadian product and mechanism must reflect the needs of Canadian donors, which in many ways are quite distinct from the American experience. There are many Canadian planned giving mechanisms which are available for Canadians and the Handbook will review and explain them. As planned giving requires the customization of a plan to a donor, the Handbook should be used as a guide, not as a step-by-step manual.

The Canadian professional - lawyer, accountant, notary, financial planner, broker, insurance agent - has a real opportunity to expand his or her client service scope by incorporating gift planning alongside the traditional estate, tax and financial planning services. The American experience has indicated that gift planning has been valuable for charities, but equally valuable to donors and their professionals.

The information contained in this Handbook reflects tax law in effect as of May1, 2010.

Jewish Gift Planning

Gift planning appears to be a relatively modern concept and cannot be characterized as Jewish. However, as a community, the Jewish people have always had the most detailed community planning mechanisms for charity.

The ancient Jews were an agricultural society. Consequently, the means of tz'dakah mirrored society; agriculture product was used as charitable payment. "Tz'dakah" is the Jewish term for charity but means much more than charity- it means doing the right thing. There is a rigorous set of rules outlining the message of tz'dakah based on the Torah, and expanded upon in minute detail in the Talmud. The Torah establishes a series of tz'dakah offerings, each with its own special calculations, interpretations, and objectives.

Some examples follow:

(a) **Pe'ah**. During the harvest a Jew was restricted from reaping the entire field. A corner of the field (the pe'ah) was left standing for use of the poor. One left approximately 1/60th of the harvest this way.

(b) **Te'rumah**. The first fruits of the new grain, wine and oil were given to the priest for his own consumption. This could encompass 1/40th - 1/60th of the crop.

(c) **Ma'aser Rishon** (first tithe). The Jewish farmer collected 1/10th of the balance of his field and transferred this tithe to the Levites, the religious administrators.

(d) **Ma'aser Sheni** (second tithe). 1/10th of the remainder was set aside for use by the owner to consume in Jerusalem. This would ensure an annual pilgrimage. This second tithe, in the third and the sixth year of the seven-year cycle, was left for the poor instead of personal consumption.

In addition, there were other Jewish taxes. On a percentage basis, at least 22% of the harvest was allocated for charity or tz'dakah. Thus, this Jewish community activity that followed the Torah was a precursor to planned giving.

Later in Jewish history the creation of the community fund by the Jewish people was a way for the Jewish community to be united and to be effective in gathering tz'dakah and allocating it properly to deserving recipients. Thus, the United Way or Centraide approach to community funding was begun thousands of years earlier by Jewish communities. Again, to establish charitable giving in a planned and effective way.

In our modern society, we no longer universally follow the teachings of the Torah and Talmud exactly as described with tithes and other Jewish taxes. However, the culture that for centuries lived through this planned giving, has been maintained by the Jewish people and has resulted in continuous generosity by the Jewish people in modern times. The planned giving approaches contained in this handbook allow the donor to exercise his generosity and his tz'dakah in a planned and effective manner.

Certainly, planned giving can be a boom to professionals, lawyers, accountants, insurance agents, etc. in providing excellent services to their clients. However, the Jewish professional can be more than a good provider of client service. Maimonides wrote that he who urges and activates others to give tz'dakah receives a greater reward than the donor himself. The Talmud's Rabbi Elazar - "the reward for one who persuades others to give tz'dakah is greater than that received by one who himself gives charity" (Bava Basra 9a).

The modern professional must serve his client and not improperly persuade his client to give tz'dakah. However, by presenting planned giving mechanisms to ease the decision making process of the donor and effectively allowing for tz'dakah, the professional has done more than serve his client, he has also performed an act of tz'dakah himself.

It is hoped that this Planned Giving Handbook will act as a conduit for Canadian professionals to create meaningful Jewish tz'dakah.

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2 Percentage Limitations and Excess Contributions

The Income Act, Canada, is structured so that donations to charitable organizations will act to reduce one's annual tax liability to the Canadian and provincial governments.

For individuals, the system works on a credit system. Federal tax credits are applied on two levels. For the first $200 of donations made a credit of 17% is available. Thereafter the credit is 29%. As 29% is also the top Federal marginal tax rate, donations can effectively be used to reduce income taxes payable at the same rate that income is taxed. Provincial tax, except for Quebec, is a function of Federal tax. Thus a donation tax credit reducing Federal tax will automatically reduce provincial tax. In this handbook, for illustrative purposes, we assume that donations are made over the $200 threshold and therefore saving tax at the highest rate. On a combined Federal and provincial level, if the top marginal rate for an Ontario resident is 46%, then the effective tax saving for a dollar of donation is 46 cents.

Quebec requires its residents to file a separate tax return. Readers dealing with Quebec taxpayers should refer to the chapter on the differences between the Federal and Quebec Income Tax Acts. For corporate tax purposes, donations yield deductions in arriving at taxable income, not credits. Effectively, the corporate taxpayer's donations reduce its taxes payable at the highest marginal tax rate.

Percentage Limitations

Although our income tax laws encourage charitable contributions, certain limitations are imposed to the extent to which such contributions may be deducted or credited currently against taxable income or taxes payable. As noted previously, for corporations a deduction is taken for charitable contributions whereas for individuals it is a tax credit. The terms "credit" or "deduction" will be used interchangeably in this handbook. **Further, in a discussion of percentage limitations the Quebec rules are a bit different from the Federal rules and therefore the chapter on these differences should be referred to.**

How much a donor may deduct as a charitable contribution in any year is determined by the application of the percentage limitation to the donor's contribution base, effectively, the net income of the taxpayer.
Net income is made up of normal income items of the taxpayer, such as salary, taxable dividends, rental income, taxable capital gains, business income, etc., less certain deductions including RRSP, RPP, child care deductions, investment expense deductions, as well as most tax shelter deductions. A donor may be limited in the amount which can be deducted in any given year based on net income. These limitations are as follows:

(a) The basic limitation for federal purposes is 75% of net income.

(b) Where a donor gifts capital property to a charity resulting in a taxable capital gain the donor is entitled to add to the basic limit 25% of that taxable capital gain. As the basic limit is 75%, by adding the 25% of the taxable capital gain, the taxpayer utilizes a donation receipt at least equal to the income which would be recognized due to the gift.

(c) Where a transfer of depreciable property occurs to a charity and recaptured depreciation results, an addition to the limit will occur to the extent of 25% of the recapture. Again, by adding the 75% basic limit this would mean that 100% of the recapture would be sheltered from tax by the donation receipt.

(d) The basic limitation is 75% for gifts to Canadian Crown Corporations as of 1997.

(e) The limit rises to 100% for a deceased taxpayer's final tax return in the year of death and for the tax return for the immediately preceding year.

Planning to Extend the Charitable Base

Except for very major gifts purposes, the movement of the Federal rules to 75% of net income plus adjustments for special gifts should mean that most donation receipts will be usable in the year the gift is made. In some situations, some planning may be needed to extend the base.

The simplest method of increasing one's base is to increase net income. Usually it is not logical to create extra taxable income in order to use a donation carry forward. However, if the use of a donation will be lost due to timing purposes, at that point it would make sense to pretax income in order to use up the donation receipt.

One method to increase net income but not taxes payable of a shareholder/manager is to change the remuneration package. As Canadian dividends received are grossed up to five fourths in computing net income switching from a salary remuneration package to a dividend package will increase the taxpayer's net income but not **necessarily** increase the taxes payable due to the dividend tax credit system.

In a shareholder/manager situation one can maximize the donation base by studying both the corporation and the individual. Put another way, if the corporation is having difficulty utilizing its donations the individual could start making donations. To fund the individual making the donation, the company could pay salary or dividends to that individual which would be deductible to the corporation and the donation would effectively be used to shelter the income in the individual's hands. If an individual is having trouble utilizing his/her donations then the corporation can be used to make the donation and use up its percentage limit. Administratively, Canada Revenue Agency (CRA) allows spouses to share their donations. Thus, if one spouse is limited in the use of donations due to the base limit, the other spouse can claim the donations on his/her tax return.

Corporations

As discussed previously, donations are utilized in arriving at corporate taxable income. In a situation where a Canadian company is the parent company of another Canadian corporation, it may be possible to extend the donation base of the parent company without creating taxable income.

This results due to the special taxation of Canadian dividends. Canadian dividends are considered taxable to the corporation in arriving at net income. As part of that income Canadian dividends form part of the limitation base for donations. However, once net income is calculated, these same Canadian dividends are deducted in arriving at taxable income. Thus increasing one's Canadian corporate dividends does not increase taxable income but does increase the donation base. Canadian corporations pay a Part IV tax on Canadian dividends received, but if the payer and recipient corporation are "connected" this tax is not exigible.

Carryovers

Contributions that exceed the percentage limitations may be carried over for credit or deduction in five succeeding tax years except after death. Whether such contributions actually may be used within the carryover period depends on the extent to which the donor has net income in those years. Pursuant to new subsection 118.1(2) applicable for taxation years commencing after 1996, taxpayers must claim or use their donations in the order in which they were made - "first in, first out". Thus the carry forward will be used up before current donations.

EXAMPLE 1

Mr. Stein donated real estate to the Federation resulting in a charitable tax receipt of $425,000, a capital gain of $100,000, and recaptured depreciation of $200,000. His net income would have been $125,000 without the donation.

Calculation of Net Income

Other net income	*$125,000*
Taxable capital gain (50 percent of $100,000)	*50,000*
Recapture	*200,000*
	$375,000

Donation Limit

(a) 75% of net income (75 percent of $375,000)	*$281,250*
(b) 25% of taxable capital gain re: donation	*12,500*
(c) 25% of recapture re: donation	*50,000*
	$343,750

Use of Receipt

Current donation receipt	*$425,000*
Use in current year	*343,750*
Available for carry forward	*$81,250*

EXAMPLE 2

Holdco owns 100% of Opco. Both companies are Canadian-controlled private corporations. Holdco has net income of $1,000,000 in the year and has made a $1,000,000 gift to the Jewish Community Foundation. It appears that the donation will be deductible in the year to the extent of 75 percent of net income or $750,000.

Holdco causes Opco to declare and pay a $333,333 dividend. Holdco retains the cash or reinvests in Opco via shares or loan. Holdco's tax return is evidenced as follows:

Calculation of Net Income

As before	*$1,000,000*
Taxable dividends received	*333,333*
	$1,333,333

Adjustments in arriving at Taxable Income

Donation (lesser of 75 % of $1,333,333 or $1,000,000)	*$(1,000,000)*
Taxable dividends	*(333,333)*
Taxable Income	*$ -NIL-*

Thus the full receipt is used in the year.

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3 Bequests

Bequests remain the number one method for charities to receive major gifts. Even so, only a very small percentage of Canadian Jews leave a bequest to their local Jewish federation or foundation. In a study undertaken by the Council of Jewish Federations over thirty per cent of respondents over age sixty-five indicated that they wished to leave a bequest to their local federation/foundation. Interestingly, only a third of those who responded positively actually had made such a provision in their will.

The basic reason for the non-adherence by the two-thirds of the group was, " no one asked them to leave such a bequest". Consequently, it follows that when professionals effect will planning with their clients, that the question is asked, "Have you considered leaving a bequest or gift to a charity within your will?" the client may do so.

There are many forms of bequests to charities contained in a will, the most basic being a specific bequest, such as the outright gift of a certain amount of money or a particular property or income source. Some testators will leave a percentage of the estate to a charity, for example, 20% of the estate to the charity. In some cases, the amount given to a charity is a residual bequest after other specific bequests have taken place, i.e., leaving a set sum of money to some relatives with the balance of the estate given to a charity or a group of charities. Finally, you may also see donors making contingent bequests, where the gift to a charity is dependent on the occurrence of another event. For example, the donor may make a bequest to the Foundation only if the original beneficiary predeceases him/her.

A method becoming more popular in leaving a gift to a charity involves the setting up of a trust within the will. This contemplates the leaving of a set sum of capital in a trust, for example, for the use of the spouse during his or her lifetime. Upon the death of the spouse, the capital will revert to the charity for charitable uses (charitable remainder trust).

Of course, this is the basic spousal trust which defers the taxation of property held within the trust. Usually the property within the trust is appreciated property which carries a potential tax liability. Thus, it is often this property within this trust which is then left as the residual interest to the charity to avoid taxation on that property.

SAMPLE WILL CLAUSES

Unrestricted Bequest

Such a bequest is an outright gift to the Foundation. The Foundation can then use this money and the income arising there from as it sees fit. A suggested clause for such a bequest is:

"I bequeath to the Jewish Community Foundation the sum of $_____ to form part of its permanent endowment."

Bequest With Specific Income Direction

Such a bequest is made when a testator wishes to leave a capital sum to the Foundation but wishes to direct how the income from the capital is to be used. A suggested clause for such a bequest is:

"I bequeath to the Jewish Community Foundation the sum of $_____ to form part of its permanent endowment. The income generated by this bequest is to be used for the (state the purposes for which the income is to be used). If, in the opinion of the Executive Committee of the Foundation, the need for funds for the purposes described no longer exists, the income may be used for the general purposes of the Foundation."

Unrestricted Memorial Fund Bequest

Such a bequest is made when a testator wishes to leave a capital sum to the Foundation through the establishment of a Memorial Fund set up in his or her name. The income from the capital will be used by the Foundation as it sees fit. A suggested clause for such a bequest is:

"I bequeath to the Jewish Community Foundation the sum of $_____ to form part of its permanent endowment and to be designated as the (name placed here) Memorial Trust Fund. The income generated by such fund is to be used for the general purposes of the Foundation."

The use of a trust can be used for others besides the spouse; for example, other relatives that one wants to ensure are taken care of during their lifetime. However, in this case, the property transferred into the trust will be subject to the deemed disposition provisions on death. Thus, cash style assets are usually used for charitable trusts for non-spouse members of the family.

Sometimes when the charity has a residual or substantial interest in the estate, the Executive Director of the charity or the Foundation is named as an executor. It is suggested that beside the Executive Director, a family member and a professional are executors to the estate.

Gifts set out in the will are deemed for tax purposes to have been made in the year of death. This rule, associated with the 100% limit rule for donations on death creates some interesting planning opportunities outlined in the chapter on Individual Estate Planning. At the least, donors should ensure that their will gifts result in the proper tax results to ensure their beneficiaries yield as large an estate as possible.

Who has made the gift-Will or Estate?

Given the 100% income limit on death, a will gift creates interesting planning possibilities.

CRA has determined that to be a will gift 5 criteria must be met:

1. It must be clear that the deceased intended to make gifts to specific charities named in the will. This sticky point has been eased more recently. It appears that giving executors the power to choose charities will be fine.

2. The amount of the donation to each charity is stipulated as a specific amount or as a percentage of the residual value of the deceased's estate.

3. The will clearly states what is to be paid from the estate in determining the amount of any residual value.

4. The will does not provide for discretionary encroachments on capital.

5. There must be a gift of law (voluntary transfer of property with out the expectation of return).

Memorial Fund Bequest with Specific Income Direction

Such a bequest is made when a testator wishes to leave a Memorial Fund in his or her name with a direction that the income from the capital be used for a specific purpose. A suggested clause for such a bequest is:

"I bequeath to the Jewish Community Foundation the sum of $_____ to form part of its permanent endowment and to be designated as the (name placed here) Memorial Trust Fund. The income generated by such funds is to be used for the (state the purposes for which the income is to be used). If, in the opinion of the Executive Committee of the Foundation the need for funds for the purposes described no longer exists, the income may be used for the general purposes of the Foundation."

Residual Bequest

Such a bequest is made when the testator sets out a percentage gift to the Foundation. A suggested clause for such a bequest is:

"I bequeath to the Jewish Community Foundation 10% of the residue of my estate after payment to the particular beneficiaries."

Trust

Such a bequest is made to ensure that a spouse, family member or other individual is cared for during their lifetimes prior to the charity receiving the property. A suggested clause for such a bequest is:

"I bequeath the sum of $_____ to a trust, the income beneficiary of which will be my spouse _____. My spouse may (or not) encroach on the capital during his/her lifetime for emerging needs at the discretion of the trustees. Upon my spouse's death the capital will be distributed to the Jewish Community Foundation"

Planners beware. Ensure there is no uncertainty in the Will to obtain the planned credits. Alternatively, if it is the estate which will shoulder the tax burden on death and not the deceased, ensure the will language is uncertain for the gift so that the estate will receive the credits.

Planning Tip:
If the testator wishes to leave an amount to charity but wishes liquidators to determine which charities should benefit he should leave the bequest to the Jewish Community Foundation, subject to an agreement with the Foundation setting the liquidators as trustees of the charitable fund to be distributed.

Planning Tip:
To take advantage of the incentive to gift marketable securities at death the will bequest should include that the "gift should be made, to the greatest extent possible, from appreciated marketable securities."

EXAMPLE

Mr. Goldberg wishes to leave a $1,000,0000 bequest to his local Federation for the purpose of building a community centre in Metulla, Israel, in memory of himself and his late wife.

Mr. Goldberg has three children who will share equally in the balance of the Estate. His annual income is $100,000. His accountant has calculated that his final tax return will evidence an additional $200,000 of taxable income due to the deemed disposition rules on death.

On death the $1,000,000 Federation gift, via his will, will be used to offset the tax on the $300,000 of taxable income in Mr. Goldberg's final tax return and the $100,000 taxable income on the preceding year's return.

It is suggested that Mr. Goldberg leave, via his will, $400,000 to the Federation which can act to shelter the income described above. The balance of the gift should be left to his three children. Mr. Goldberg, the Federation, and the three children should enter into a contract obliging the three children to gift $600,000 to the Federation upon receipt of these funds from the estate.

The children will each receive a $200,000 charitable donation receipt which they can use to shelter income from tax in the year of gift or in the five subsequent years. Approximately $275,000 of additional tax savings will be realized.

Gifts in contemplation of death

This is a gift made during one's lifetime which takes effect on death. For example, a very ill person transferring property to a charity, has the option to take back the gift if he or she recovers.

CRA's position is that the gift only becomes effective at death (the charity receipt only available at death). This position is not necessarily correct but beware of this policy, as the gift at death is not a will gift and, therefore, deemed to have been made in the deceased's final tax year. Instead, the estate would use the receipt against the estate's income and not on the final tax return.

4 Gift...Plus Annuity

Charitable gift annuities are an excellent gift planning mechanism for those donors who wish to leave the Federation a sum of money but would like to ensure that the donor and/or his spouse receive an annual set income for their lifetimes as a consequence of the gift. It is particularly valuable for donors in their seventies and eighties. The chapter entitled Charitable Remainder Trusts reviews another plan to offer donors income during their lifetime.

For a charity to issue an annuity it is in essence entering the insurance field. A life annuity contemplates setting out an obligation by the charity for the life of the donor. Since one does not know the life expectancy of the donor, then there are risks involved by the charity issuing such an annuity similar to the risks that an insurance company assumes. An insurance company, through its actuaries and investment division, and because of the vast number of clients that it serves, will be able to determine the costs of the risks and therefore set out relevant prices for its annuities.

A charity typically does not have this expertise and although CRA allows charities to issue annuities, it is only the most sophisticated who should do so and those who have the right to do so under their charter. CRA's position is that foundations cannot issue annuities as "debt" is created. Most charities, however, can market charitable gift annuities by reinsuring the annuity via an insurance company so that the insurance company covers the risk and not the charity. This reinsurance or gift...plus annuity is best described as follows:

> *The premise of gift...plus annuity is for a donor to "invest" a sum of money in the charity, on which the charity will pay to the donor a guaranteed set return for the life of the donor and sometimes for the lives of the donor and his/her spouse.*

The CRA position on gift...plus annuity is strictly administrative. Its bulletin on the issue IT-111R2 has been withdrawn. The new policy is best described via an example:

EXAMPLE

The donor transfers $100,000 to a charity.

Life expectancy	*10 years*
Annual annuity	*$ 8,000*
Cost of the annuity	*$ 50,000*

Tax results:

Receipt issued *$50,000*
(Amount transferred $100,000 less cost- $50,000)

A portion of the annuity received annually will be taxable, based on the normal calculation for a $50,000 cost annuity.

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5 Life Insurance

Life insurance is an important tool in the estate and gift planning process. The key to life insurance is that proceeds received due to death are received tax-free. As 100% of gifts are deductible on the final tax return, and gifts left via a will are usable in the final tax return, interesting planning possibilities arise.

It is noted that the following examples in this chapter utilize simple insurance products. These examples are meant as a guide. When actually acquiring suitable product, it is probable, in many cases, that more varied and diverse insurance product will be used.

In General

Life insurance can be an important element of an estate plan for wealthy individuals, owners of closely held businesses and persons of more modest means. The principal uses of life insurance in estate planning include:

(1) creation of a fund for a family's support in the event of an untimely death of a family provider with a spouse and children;
(2) providing liquidity to pay estate taxes and administrative expenses for an otherwise illiquid estate;
(3) funding buy-sell agreements and key-person protection for the closely held business; and
(4) shifting wealth to prospective heirs at little or no transfer tax cost.

Types of Life Insurance

The major categories of life insurance are briefly described below. The insurance industry has experienced a renaissance in the past 10 years and new types of products are constantly being developed to suit various specific needs. The following discussion is limited to an overview of the major types of products currently available.

1. Term Insurance

Term life insurance provides insurance protection for a limited period of time, usually annually. A term insurance policy pays a fixed death benefit if the insured dies during the term of the policy. Term insurance is frequently renewable, but premium costs increase as the insured grows older. Continued coverage ultimately may be denied or become more expensive if the insured subsequently develops any medical conditions that would affect insurability. Term insurance has no cash surrender value (discussed below), and it provides no benefit when it expires. Term to age 100 is a term insurance product with level premiums for life.

2. Permanent Insurance

The term "permanent insurance" describes a number of products that may be sold under various names within the insurance industry. The primary features that distinguish permanent insurance from term insurance are generally as follows:

(1) As long as the contract is retained in force, there is a fixed death benefit (sometimes variable) payable at the insured's death and there is no requirement of further medical exams or proof of insurability after the initial policy is acquired.

(2) The premiums paid in the early years of the policy exceed the amount necessary to provide the death benefit under the contract.

(3) This excess premium payment is retained as a cash reserve which is credited each year with a growth factor similar to interest. The balance in this cash reserve is referred to as the "cash surrender value" and this is the approximate amount (net of borrowing) that would be paid to the owner of the policy if the insurance contract was terminated or cancelled prior to death.

(4) The cash reserve may be borrowed by the owner of the policy, generally at market or more favourable interest rates. The cash reserve is also designed to supplement the annual premium payments in the later years of the contract since the annual cost of the insurance death benefit will be greater than the required premium payment.

The 2 most basic forms of permanent insurance are "whole life" and "universal life" (sometimes called "flexible premium") policies.

Whole Life Insurance

A whole life insurance policy is a form of permanent insurance with fixed level premiums payable throughout the insured's lifetime or for a specific number of years. There is usually a minimum annual growth factor that is guaranteed, and the growth factor may exceed the guaranteed annual rate under favourable market conditions. Compared with universal life insurance (discussed below), a whole life policy will generally be more expensive but will be less susceptible to investment risk. This is because the insurance company bears a greater share of the risk that the cash reserve will not be sufficient to supplement the premium payments in the later years of the policy.

Universal Life Insurance
Universal life insurance is generally more flexible than whole-life because the owner of the policy may vary the amount of the annual premiums. If excess premiums are paid, the policy builds up a larger cash reserve which essentially serves as an investment portfolio. Reduced premium payments will diminish the cash reserve, ultimately resulting in a smaller death benefit or a longer required period of premium payments. Growth rates on universal life policies fluctuate with money market conditions and often are more favourable than rates on traditional whole life policies.

However, this volatility can work against the policy owner in the event of a declining interest rate environment. Although there may be minimum annual growth factor guaranteed, the owner of a universal life contract assumes a much greater share of the risk that the actual growth factor will not be sufficient to sustain subsequent premium payments.

3. Vanishing Premium Life Insurance

Both universal and whole life policies can be structured so only a specified number of annual premium payments are required. As described above, the excess cash payments combined with the projected growth factor are calculated to produce a sufficient cash reserve to fund the annual premium payments on an ongoing basis. The growth factor is not subject to income taxation. Therefore, the cash surrender value of the policy grows faster than an otherwise taxable investment portfolio growing at a similar rate.

Investment return, fees and broker's commissions (which are negotiable) vary widely on vanishing premium policies, and favourable tax treatment is not assured in the future. Accordingly, projections and policy guarantees under vanishing premium policies should be scrutinized with care and treated as a speculative investment, particularly when a universal life insurance product is being considered.

These policies have often been called single premium policies, as it is possible to pay up the entire policy with a single payment. Revenue Canada taxes a deemed interest amount on an annual basis for this type of policy. Obviously, if the charity holds the policy this is not an issue as the charity is exempt from income tax.

4. Survivorship Life Insurance

A principal goal of estate planning for married persons is to defer any significant estate tax until the death of the surviving spouse. Survivorship policies (also called "second-to-die" policies") are designed to insure the joint lives of a married couple.

Survivorship policies are often used to provide money for the payment of estate taxes or to provide liquid funds to descendants of a married couple at the death of the second spouse. No insurance proceeds are paid on the death of the first spouse, and the premium payments continue until the death of the second spouse. These costs should be carefully considered as part of the insurance planning. Survivorship policies can also be purchased among a number of siblings, and operate on the same principle.

Because survivorship insurance is based on a minimum of two lives, it is significantly less expensive than a single-life insurance policy. Survivorship life insurance also is useful to obtain more favourable premiums when one spouse has a medical history that would prevent his or her insurability at reasonable rates. These policies are often used in conjunction with individual or corporate estate and gift planning strategies.

Life Insurance as a Tax Shelter

Like RRSPs, if properly set up, a life insurance policy provides for the accumulation of value within the policy without taxation. Unlike RRSPs, the premiums paid are generally not tax deductible (the exception is for policies required as part of financing arrangements) but the proceeds received on death are tax-free. This treatment allows for some interesting planning options.

Life Insurance Gift Planning

The Life Insurance Program

For relatively small donations a large endowment can be left to the community via a life insurance program. The following illustrates what an annual donation made for five years can create in terms of proceeds on death due to life insurance. Note that the quotes below are illustrative only as premium costs vary continuously. It is assumed that the insured below are non-smokers. (Thanks to Luc Bordeleau of GEP Inc. for providing the figures.)

The tables illustrate the effect of creating an insurance policy whose premiums will be paid over a five-year period. Referring to the Female-50 Years table, if a charitable gift of $2000 a year for 5 years is made in order to fund the premiums, a paid-up policy of $90,848 (the proceeds received on death) will be achieved. The cash surrender value after the 5-year period will be $8000.

Male - 30 years		
Premiums 5 years Gift per year	Insured Value	Cash surrender value after 5 years
$1,000	$137,775	$4,000
$2,000	$308,000	$8,000
$3,000	$466,600	$12,000
$4,000	$600,000	$16,000
$5,000	$800,000	$20,000

Female - 30 years		
Premiums 5 years Gift per year	Insured Value	Cash surrender value after 5 years
$1,000	$171,300	$4,000
$2,000	$378,450	$8,000
$3,000	$475,000	$12,000
$4,000	$650,000	$16,000
$5,000	$825,000	$20,000

Male - 40 Years		
Premiums 5 years Gift per year	Insured Value	Cash surrender value after 5 years
$1,000	$ 62,725	$4,000
$2,000	$151,219	$8,000
$3,000	$232,815	$12,000
$4,000	$317,000	$16,000
$5,000	$396,850	$20,000

Female - 40 Years		
Premiums 5 years Gift per year	Insured Value	Cash surrender value after 5 years
$1,000	$81,675	$4,000
$2,000	$193,465	$8,000
$3,000	$298,295	$12,000
$4,000	$406,800	$16,000
$5,000	$508,000	$20,000

Male - 50 years		
Premiums 5 years Gift per year	Insured Value	Cash surrender value after 5 years
$1,000	$30,670	$4,000
$2,000	$66,700	$8,000
$3,000	$109,790	$12,000
$4,000	$147,400	$16,000
$5,000	$185,000	$20,000

Female - 50 Years		
Premiums 5 years Gift per year	Insured Value	Cash surrender value after 5 years
$1,000	$41,775	$4,000
$2,000	$90,848	$8,000
$3,000	$148,100	$12,000
$4,000	$198,880	$16,000
$5,000	$240,000	$20,000

Male - 60 years		
Premiums 5 years Gift per year	Insured Value	Cash surrender value after 5 years
$1,000	$11,485	$4,000
$2,000	$35,930	$8,000
$3,000	$55,180	$12,000
$4,000	$74,435	$16,000
$5,000	$93,735	$20,000

Female - 60 Years		
Premiums 5 years Gift per year	Insured Value	Cash surrender value after 5 years
$1,000	$15,575	$4,000
$2,000	$51,315	$8,000
$3,000	$78,810	$12,000
$4,000	$109,515	$16,000
$5,000	$137,915	$20,000

Maintaining Assets Within the Family

Often, families own business or personal assets which have significantly appreciated in value and therefore, can create an income tax liability on the second death of the parents. If it is important that the children maintain these assets, then it is clear that an income tax liability will arise, which may precipitate the selling of these assets even if that is not the intention of the testator. One solution is for the testator and his/her spouse to purchase insurance for an amount equal to the estimated taxable income pertaining to the asset. The testator will provide for a charitable gift in his/her will which will be funded by life insurance proceeds payable to the estate. Upon death, the estate, for purposes of completing the final tax return, will receive a donation receipt equal to what is set out in the will which will offset the taxable capital gain created on the deemed disposition of the asset to be retained. Thus, no tax is payable. The gift to be paid to the estate is funded via life insurance received by the estate on a tax-free basis.

This type of planning can be used for a second home, shares of private companies, or other assets where significant taxes would be paid. Special emphasis should be made on assets like real estate, which can yield significant tax liability due to realized capital gains and recapture and poor liquidity.

New Life Insurance

For gifts of new life insurance, the income tax deduction relating to the creation of a policy is the amount of premium contributed for the purchase of the policy. A gift of $1,500 to the Federation to pay for the premiums on a $100,000 policy, will actually cost the donor $805, after tax (for an Ontario resident). The gift of life insurance enables the donor to leverage a relatively small contribution into a dramatically large gift.

By creating this substantial benefit, the donor can endow his or her own philanthropy. The ability to support a charity normally ends with the donor's death. By establishing an endowment fund with the Foundation through life insurance, the donor is able to create an asset from which the income will perpetuate the donor's annual giving forever. Life insurance will pass to the Foundation immediately upon the donor's death, avoiding the time and costs of probate.

Existing Life Insurance

The contribution of a paid-up policy or a policy that has been in effect for several years but which requires additional premiums, entitles the donor to an immediate income tax deduction equal to the value of the policy. Often the value of this policy is greater than the cash surrender value. The charity should endeavour to determine the true market value of the policy to determine the gift and tax receipt issued. Under the ITA the proceeds of disposition are still the cash surrender value. Thus, you could get a large receipt and little corresponding income. This yields interesting planning.

Old policies that are no longer needed by the donor or donor's family can create current tax benefits. Often these policies, purchased originally to protect the spouse and young children and provide liquidity for the family, outlive their usefulness. After the children have grown and the protection for which the insurance was purchased has been provided by other assets, the insurance can be used to satisfy a charitable donation.

These matured policies have the additional advantage of providing substantial cash values available to the Foundation. The cash in the policies and future dividends earned will often be sufficient to pay future premiums, without further contributions by the donor or cost to the Foundation. Alternatively, the cash can be withdrawn by the Foundation for its immediate use.

How to make a gift of life insurance

A gift of new life insurance can be arranged by applying for a policy, naming the Foundation as owner and beneficiary. The initial and future premiums should be gifted directly to the Foundation, to maximize the allowable deductions to the donor. The donor may elect to contribute the premiums annually or in a lump sum. A gift of existing life insurance can be achieved by utilizing the following form:

"I, John Donor, hereby assign to the Jewish Community Foundation, all of my right, title and interest in the life insurance policy on my life issued by ABC Insurance Company No. 123 in the face amount of $50,000."

EXAMPLE 1
Leveraging a large gift

Rhoda Vineberg, age 52, wishes to endow her Federation with her Lion of Judah annual gift. She will purchase a $100,000 life insurance policy to benefit the Federation. ***Cost of Single Premium- $11,000***

She remits $11,000 to the Federation. The Federation purchases the fully paid-up policy with the donation. Rhoda receives a donation receipt which reduces her after-tax cost to approximately $6,000. At a net cost of $6,000 a future gift of $100,000 will be received.

Assuming an after-tax discount rate of 4% the present value of the policy is described as follows, given the following life assumptions;

Rhoda lives to age 102	*$14,071*
Rhoda lives to age 92	*$20,829*
Rhoda lives to age 82	*$28,506*
Rhoda lives to age 72	*$45,639*
Rhoda lives to age 62	*$67,556*

For a relatively inexpensive after-tax cost of $6,000, significant value is created even on a present value basis. The above demonstrates how Rhoda would have to invest $20,829 today, earning income at a compounded after-tax-rate of 4%, to accumulate $100,000 at age 92 to gift to the Federation. Her after-tax cost of $6,000 today to purchase the policy achieves the same result.

EXAMPLE 2
Life Insurance as a tax shelter

Mrs. Weiss, age 55 wishes to leave a significant bequest to the Federation, but does not wish to reduce her family bequests. She has significant assets which are not needed to support her lifestyle.

The Federation, acting as agent for Mrs. Weiss, will purchase a $500,000 life insurance policy. Mrs. Weiss will remit $14,733 a year for 6 years (total $88,398). Mrs. Weiss enters into an agreement with the Federation whereby on death, half the proceeds of the policy will be retained by the family, with the balance transferred to the Federation.

$250,000 of policy is for family and the other $250,000 is for the Federation. Half the annual premium will be eligible for a tax receipt. The policy, although issued at a face value of $500,000, carries a death benefit which grows over time. Thus, death at age 75 would yield tax-free proceeds of $611,124; at age 100 $1,000,000.

The following schedule compares the accumulated value of the $88,398 if it were invested at 9% and compounded at the after-tax rate of 4.5% to the family receiving one-half of the death proceeds. We add to the policy proceeds the value of the tax savings due to the donation receipts provided by the Federation invested at the after tax rate of 4.5%.

Age at Death	Invested	50% of Policy	Value of Tax Savings	Total Value Reinsurance
71	$152,000	$298,000	$38,000	$336,000
87	$304,000	$352,000	$76,000	$428,000
90	$347,000	$373,000	$86,750	$469,750
94	$414,000	$412,000	$103,500	$515,500

Mrs. Weiss' family will receive proceeds at least equal to the existing situation. In addition, the community receives a terrific gift. The extra value is created by virtue of the fact that tax is not paid on the accumulated values within the policy.

Wealth Replacement

The ability to receive life insurance proceeds on death free of tax allows for the replacement of capital used to fund major gifts. This is particularly effective in a corporate set-up, as the transaction will save estate taxes as well. Please refer to the chapter on Corporate Estate Planning. Insurable donors should examine wealth replacement insurance when making a major gift.

EXAMPLE 3
Wealth Replacement

Assume Mrs. Vineberg from Example 1 remits $7,000 annually to the Federation. To fund such a gift she invests $100,000 earning 7%. The income earned is offset by the charitable receipt for tax purposes.

Alternatively, Mrs. Vineberg makes a gift of $100,000 to the Federation with instructions that the income earned from the gift will be used to fund her annual gift. The Foundation will transfer the income from the funds, say $7,000 to the Federation, but it will do so in the name of Mrs. Vineberg. No annual $7,000 receipt will be issued to Mrs. Vineberg.

In essence, the $100,000 is still being used to benefit Mrs. Vineberg. Her financial situation has not changed from a practical point of view. The donation receipt of $100,000 will save almost $50,000 of tax.

A portion of the tax savings will be used to purchase a $100,000 policy. A single premium policy will not be purchased, as the beneficiary of the policy will be the family. A six-year premium payment will be chosen to avoid the annual investment accrual rule. $2,200 of premiums will be paid annually over a 6-year period at a total premium cost of $13,200.

On death, the $100,000 is received tax-free by the family to replace the $100,000 originally donated.

The tax savings on the original gift of $50,000 is reduced by the $13,200 in premiums. The remaining cash flow of $36,800 is kept as a bonus by the family.

Conclusion

The tax-free value of insurance allows for exciting Canadian-made gift planning. There are countless possibilities which the professional planner can take advantage of. Throughout this handbook various plans are explored using life insurance.

Using Cash Surrender Value

The Universal policy which creates cash surrender value can present planning opportunities.

EXAMPLE 4
Universal Policy

Norman, age 40, takes out a $100,000 Universal Policy. The premium cost is $3,200 a year for 10 years. Norman contracts with the Federation that upon his death, the death benefit received by the family will be donated to the Federation. The family will retain life insurance proceeds equal to the premiums paid not returned to Norman during his lifetime. The gift will be set out in Norman's will. The policy builds cash surrender value. In years 11 to 20 the policyholder will remove $3,200 a year to recover the premiums paid.

The Federation will receive a gift on death as follows:

Age at Death	Death Benefit $	$ Kept to Repay Premiums	Gift to Foundation $
45	$115,157	$16,000	$99,157
55	$126,025	$16,000	$110,025
65	$113,636	-	$113,636
75	$117,009	-	$117,009
85	$123,169	-	$123,169
95	$134,418	-	$134,418

As the ultimate gift is donated via his will, the donation receipt will be used in Norman's final tax return. The receipt will be usable against 100% of income.
Tax savings are realized on death, and a great gift is made at the effective cost of financing premiums over a 20-year period, since after 20 years all premiums have been repaid.

Direct Designations

Gifts of insurance proceeds made in a will result in a donation credit on the final tax return. For deaths occurring after 1998 the credit is available for gifts of policies made through direct beneficiary designations even if not in the will.

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6 Insured Annuity

A popular investment and insurance product is the insured annuity. The investor typically in his sixties or seventies, is sold on the premise that investing in term deposits yields significantly lower after-tax returns than converting the term deposit into a life annuity and using a portion of the annual annuity proceeds to fund a life insurance policy to replace the capital used to purchase the annuity.

This investment technique can be used to fund a charitable gift. The objective would be to create an after-tax return equivalent to current market yields, replace the capital for the family and create a substantial gift.

EXAMPLE 1

Mr. Trachtenberg is 72 years of age. He owns a family business and has amassed substantial sums of liquid assets in his own name. He contributes $100,000 a year to the Federation. He wishes to perpetuate his annual gift upon his death, although he does not want to impair his bequests to his children. Mr. Trachtenberg presently owns a $1,000,000 term deposit earning after-tax interest at a rate of 3%.

Mr. Trachtenberg assigns the Federation to be his agent to affect the following:

(1) Cash in his $1 million term deposit and with the proceeds purchase a life annuity yielding $125,000 per year.

(2) Purchase a $1 million life insurance policy. The annual premium is $42,500 and the beneficiary of the policy is the family.

(3) Purchase another $1 million policy where the beneficiary is the Federation, also at a cost of $42,500. A portion of the life annuity is taxable. The premium paid to support the Federation policy will yield a charity receipt. On a net basis, approximately $10,000 of tax will be paid annually

.

Results:

(1) Mr. Trachtenberg will receive $125,000 of cash flow annually but spend $42,500 twice for insurance and $10,000 for tax. He is left with $30,000 after tax (3% return).

(2) His family recovers the $1 million of capital used on death via the receipt of the tax-free insurance proceeds.

(3) *The community will receive $1 million on death.* **Thus, his annual contribution is maintained.**

The numbers above do not always work out as well as in the example. The donor, if the annual cash flow is less than desired may choose to take out a smaller policy for the Federation.

Some donors do not wish or need to replace the capital of the gift and can therefore improve the donor's annual income. Note Example 2.

The insured annuity technique works very well in a corporate setting and is described in the chapter on *Corporate Estate Planning.*

EXAMPLE 2

Mr. Trachtenberg decides it is unnecessary to replace the capital for his family.

Based on the previous example he will receive $125,000 annually and spend $42,500 for the Federation's policy and $10,000 for tax.

His after-tax cash flow is $72,500 or a 7.25% return after tax, equivalent to a 14.5% pre-tax income.

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7 Retractable Donation

The term retractable is well known to Canadian professionals. It is used to describe certain preferred shares where the holder of the shares has the right to demand the redemption of the shares at any time.

The retractable donation is a donation that can be retracted at the volition of the donor. In the United States it is known as a lead-trust and sometimes in Canada as an interest-free loan.

Effectively, the donor makes a loan to the Federation. As the loan can be retracted, the transfer of property is not irrevocable and therefore no charitable receipt will be issued.

The income earned by the Federation from the loan proceeds can be used for charitable purposes at the direction of the donor. Annually the donor will not be taxed on the income; neither will he/she receive a tax receipt.

Since Foundations cannot hold debt it must structure the loan via a trust governed by the Foundation.

EXAMPLE

Mr. Pinchuk is a successful businessman. He earns a considerable annual salary and has accumulated significant capital which is invested conservatively. Mr. Pinchuk sees these funds as his nest egg. He, of course, pays tax at the highest level on the investment income earned. He wishes to build a fund within the Federation but does not want his nest egg impaired for himself or his heirs.

Mr. Pinchuk loans a Foundation trust $1,000,000. The Foundation is the income beneficiary of the trust. If ever Mr. Pinchuk wishes to recover the $1,000,000 he demands repayment from the trust.

Mr. Pinchuk can request that the interest accumulate in the Foundation in a fund carrying his family's name. At a particular point in time, the fund can be used to "purchase" a community project in his family's name.

Over time, as the donor is able, he may forgive the loan to the Federation. The amount forgiven will be used to calculate the donation receipt. A forgiveness on death will yield a receipt usable on the donor's final tax return.

8 Stripped Bonds

A stripped bond is an investment (a loan) to an entity (often a government institution) from which the usual interest coupons have been "stripped" (removed). To sell this seemingly less interesting bond, the bond is sold at a discount from face value.

A $100,000 bond could be sold for say $20,000. At maturity the bondholder will receive $100,000. The $80,000 gain is effectively investment income and CRA expects you to accrue and pay tax upon the annual gains.

Like insurance, a gift of a stripped bond enables the donor to leverage a relatively small contribution into a large gift. The advantage of a stripped bond to a donor is that he/she is likely to see his/her gift mature, unlike a gift of life insurance where the donor will not live to see the gift benefit the community.

EXAMPLE

Mr. Bernstein transfers $17,584 to the Federation and instructs the Federation to purchase a stripped bond with the donation. He receives a charitable receipt of $17,584.

The Federation purchases a 25 year Ontario Hydro $100,000 bond yielding 7.2% annually built into the $17,584 purchase price.

In 25 years the $100,000 bond will cashed in by the Federation and a charitable fund will be established in Mr. Bernstein's name.

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9 Charitable Remainder Trusts

Introduction

There are several methods of gifting property of substantial value to federations or foundations and yet retain the benefit of an income equivalent from the property for life or for a specified period of time. A charitable gift annuity is one such plan. Another, which is exceptionally popular in the United States, is the Charitable Remainder Trust.

Description

A Charitable Remainder Trust ("CRT") is a planned giving concept derived from the US. In Canada there is no such legal entity. Unlike the US, where the Internal Revenue Code contemplates the CRT in legal fashion, there is no such mention in the Canadian Income Tax Act. Under Canadian law, a CRT is a trust, plain and simple, and certainly not a charitable organization. How a Canadian is deemed to have made a gift to a charity when a transfer of property to a CRT is based on logic, but more on Interpretation Bulletin IT-226R (reproduced in the Appendix) which deals with the transfers of residual interest to a charity. Without the specific provisions within the Income Tax Act, there are uncertainties as to certain applications of CRTs. (Reference can be made to an article by Blake Bromley of Blake Bromley Consulting Inc., Vancouver, BC entitled "Creative Planning of Charitable Donations" 1996 Conference Report, Canadian Tax Foundation, November 1996, Montreal, Canada.)

The CRT is a trust which holds capital transferred by the settler or donor. Effectively, the trust will pay income to the donor or other named income beneficiary during his or her lifetime and then distribute the capital to the charity upon the death of the income beneficiary.

The Interpretation Bulletin IT-226R sets out CRA's position as to what is a valid Charitable Remainder Trust. The most important requirement in relation to the establishment of the gift is that property is transferred to the trust irrevocably. In this way, no one can remove capital from the trust except the charity. The donor cannot have any right of encroachment. This type of trust is different from the typical spousal trust, which allows for the spouse to be an income beneficiary for life but also allows for capital encroachment during the spouse's lifetime. If a spousal trust is set up as a Charitable Remainder Trust, CRA will disallow the transfer of property as a gift to the trust due to this encroachment provision. A spousal trust without the encroachment provision whereby the capital on death of the spouse would be left to the charity would be considered a valid CRT.

What are the benefits to the donor of establishing a charitable remainder trust? First and foremost, is the establishment of the gift during the lifetime which the donor knows will be available to the charity for its full use upon the donor's death. Next, an annual income flow will be realized by the donor or designated beneficiary. Usually the charity manages the investment of the CRT. The donor appreciates that a professional methodology of obtaining such an income flow is now being taken from his/her hands and placed in others, which may be capable of obtaining a higher return with relatively low risk. Moreover, the donor, depending upon the facts, may have the opportunity of receiving a donation receipt immediately upon transfer to the trust. Particularly with the movement of the donations limit to 75%, this could enable the donor to realize substantial tax savings today in relation to the disposition of property which effectively he/she will be living on the rest of his/her life. Lastly, costs of probate are avoided.

Realization for Tax Purposes

As a CRT is a normal trust like any other, any property transferred to the CRT will be deemed to be a disposition for tax purposes. This may result, depending on the value of the property and its adjusted cost base, ("ACB") in a capital gain or loss. Because the donor is maintaining an income right for life (and perhaps

for a spouse) the disposition is not complete. In essence, what is transferred to the trust is the remainder value of the property and not the life interest of the property.

How does one determine what are the proceeds of disposition of the property or the value of the gift in order to calculate a donation receipt?

> **EXAMPLE 1**
> **Calculation of a CRT Gift**
>
> *Assume the following:*
> - *$100,000 transfer*
> - *Male donor, age 78*
> - *IT -112R2 evidences a 10 year mortality*
> - *Bank of Canada interest rate on a 10 year security is 6.5%*
> - *$100,000 discounted at 6.5% for 10 years is $53,272*
>
> ***Thus, a charitable donation receipt of $53,272 is received by the donor to be used immediately on the donor's tax return.***

Legislation is not offered to determine the methodology for computing the gift, and thus basic logic must be used. As the donor is maintaining a life interest, the length of that life is very important in determining the value of the gift. Obviously, the older the donor, the fewer years in which income will be received by the donor and the sooner the charity will receive the gift for full use. Consequently, mortality is very important in determining the proceeds of disposition and the gift. The other key factor is a discount rate for income which could be earned by the property.

Interpretation Bulletin IT-112R2 (see Appendix) sets out a mortality table according to 1983 statistics. It is what CRA has suggested that Canadians use for purposes of determining tax treatment of charitable gift annuities. Consequently, this table should be acceptable by Revenue Canada to be used for the calculations.

The discount rate is more difficult to determine. Should one use CRA's prescribed rate? Perhaps, but from an economic point of view this may not be quite accurate. Probably the best discount rate to use is the Bank of Canada investment rate for the period of time of mortality. What this means is, if mortality is two years, then the discount rate could be the Bank of Canada investment rate for two years. If mortality is thirty years, the Bank of Canada thirty-year investment rate could be utilised. This methodology is fair and probably would be accepted by CRA. CRA may have some difficulty in determining discount rates for property that is not cash or similar to cash, eg. business assets.

How would one provide a discount rate for a restaurant, for example? One would argue that in determining the value of the restaurant one would, in essence, discount the value because of the type of asset and the risky nature of the restaurant industry. However, Revenue Canada might determine that if mortality is quite long and since the restaurant business is quite risky, then a special discount may have to be calculated.

Thus, to calculate the proceeds of the disposition, take the full value of the property at the date of transfer to the trust and discount this value by an interest rate (discount) factor using mortality as the number of years in the calculation. The result would be the proceeds of the disposition and this amount would be the donation receipt for the donor.

To calculate the resulting capital gain or loss, what would be the adjusted cost base to be used? Presumably the asset would have a cost base which is known. If the value of the property is $100,000 and the gift or proceeds of disposition is determined to be $60,000, 60% of the actual value of the property, then one would apply 60% of the adjusted cost base as the cost base for the remainder interest of the property which has been transferred to the trust. The rest of the cost base would effectively be the cost base

attached to the life interest which is being maintained in the trust. The attached examples will review the calculation of proceeds at disposition and the allocation of the adjusted cost base.

However, with the new Federal rules which ensure that one can use a full tax receipt against a taxable capital gain on a transfer of capital property to a charity, it does not seem that there would be any use in electing (except, perhaps, for Quebec).

Enhancing the Annual Return of the donor by transferring appreciated property to a CRT

Assume the taxpayer has accumulated assets with market values far greater than their cost. This taxpayer wishes to cash in his/her assets and with the proceeds, create an annual return on which to live. The problem is that cashing in will result in capital gains tax, reducing the capital to be reinvested for living purposes.

If the taxpayer transfers the residual interest in these assets to a CRT, he/she would retain the life interest, i.e., entitled to the income generated from the assets in the trust for his/her lifetime. As described previously, the taxpayer would realize proceeds of deposition and a donation receipt equal to a computed value based on the transfer of the residual interest of these assets. Any income created in the transfer would be offset by the charity receipt. The trust would own the marketable securities.

EXAMPLE 2
Calculation of CRT
Appreciated property gift

Assume the donor described above transfers $100,000 of BCE stock.

Original ACB : $25,000
Donation receipt
(as in Example1) $53,272

The proceeds of disposition are $100,000. However, the donor elects that his proceeds are $53,272 (subsection 118.1(6).

Capital Gain Calculation

Proceeds	*$53,273*	*ACB*	*$25,000*
Capital Gain			*$28,273*
Taxable (50%)			*$14,136*
Donation Receipt			*$53,272*

If the trust were then to subsequently sell these securities, no gain would result, as the ACB to the CRT would be the FMV of the shares at the transfer date. The trust is then in a situation where, once it has sold the securities it has the full amount of capital available. Thus, as it invests these assets in annual investment style assets e.g. bonds, the income that is earned on those investments will be fully allocable to the income beneficiary of the donor. Consequently the donor has, in essence, created a mechanism to have his/her marketable securities sold and with the full proceeds received on sale, reinvested for purposes of creating a life income. Note that with the increased or enhanced income, the donor might decide to invest that income in a life insurance policy to perhaps replace some or all of the capital that is "lost" to the family by the transfer to the CRT. The capital to be replaced would be the amount of the value of the marketable securities, less the tax that would have been paid on actual disposition or on death. A transfer of listed marketable securities to a CRT is not eligible for the reduced Federal inclusion rate for taxable capital gains.

What is the capital gains effect to the donor resulting from the transfer to the CRT? CRA's position is that the proceeds of disposition equals the full value of the property, not an opinion shared by all and appearing onerous given the fact that the donation receipt is discounted. However, there is a way out. CRA administratively via IT-226R allows a taxpayer to utilize subsection 118.1(6) on a transfer of capital property to a CRT. This election allows a taxpayer to elect his proceeds of disposition on a transfer of property to a charity to, at his/her choice, anywhere between the ACB and FMV. This obviously will

reduce the capital gain; it also, however, reduces the donation receipt to the elected amount. In a CRT transfer the election will be made at a discounted value, or the amount of the donation receipt.

Transfering depreciated properties to a CRT

It appears that transferring a property which has lent value to a CRT will mean that the capital loss normally calculated will be unavailable for tax purposes.

Conclusion

The charitable remainder trust is an excellent charitable giving tool. The options available are many. The trust can choose to invest with the Foundation's other assets. The trust can invest on its own and follow the investment policies of the donor. The assets transferred can vary. They can be cash, marketable securities, real estate, or even a business. The possibilities for seeing an enhanced income for life through the disposition of appreciated assets makes the CRT again, a very interesting vehicle for planning.

Note that income paid to the donor or spouse from the CRT is taxable, which differentiates the CRT from Gift...Plus Annuity.

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EXAMPLE 3

Assume that the donor could have sold the stock and reinvested the net proceeds at 7%. Compare to CRT return assuming the same 7% return.

	Personally	**Sale of shares within the CRT**
Proceeds	*$100,000*	*$100,000*
ACB	*25,000*	
Capital gain	*$75,000*	
Taxable (50%)	*$37,500*	
Tax (at 48%)	*$18,000*	
Net proceeds after tax	*$82,000*	*$100,000*
Annual Income (7%)	*$ 5,740*	*$7,000*
Enhanced Income	*$1,260*	

9 Gifts of Residual Value

Very similar to the Charitable Remainder Trust ("CRT"), the gift of a residual interest contemplates the transfer of an asset, not necessarily to a trust governed by the Federation/Foundation, but directly to the charity. In this case, there will be no income allocated during the lifetime of the donor, but instead the use of the asset will be available to the donor and perhaps other members of the family for life. For example, if a donor wishes to transfer his principal residence to the Foundation, he could do so as a gift of residual interest. The use of the home for the rest of his and his spouse's wife will be kept by the donor. On the death of the donor and the spouse, the charity will then have the full use of the house presumably to be sold at that time for cash.

The reason the donor would enter into a residual interest gift (besides the act of charity), is to receive a donation receipt immediately, even though the actual use of the asset will be available for life. Like the calculation of the donation receipt for the CRT, one would examine, at the date the gift is made, the value of the property transferred, the mortality of the users of the property, and a discount rate based on market interest rates at that time.

There is a deemed disposition for tax purposes. Also, identical to the CRT, it is not the complete asset which has been disposed of, but just the residual or terminating interest of the property. The life interest in the property has been retained. The calculations in determining the proceeds of disposition and allocation of cost base are identical to that found for CRTs. Again, the taxation of this gift mechanism is governed by Interpretation Bulletin IT-226R (see Appendix). What is key to this gift, again like CRTs, is that the gift must

of cost base are identical to that found for CRTs. Again, the taxation of this gift mechanism is governed by Interpretation Bulletin IT-226R (see Appendix). What is key to this gift, again like CRTs, is that the gift must be transferred irrevocably to the charity to issue a charitable donation receipt to the donor.

There are very few types of assets where gifts of residual property would occur. Typically, we are talking about personal use assets such as a principal residence or artwork. From a tax point of view, the principal residence residual gift transfer can make a lot of sense, given the fact that usually there is no need to recognize the capital gain on the deemed disposition of the residual interest. The reason for this is the special exemption from capital gains tax for properties which are principal residences. If this is the case for the donor, then the transfer to the charity will not result in a taxable capital gain but the receipt would still be calculated in the normal manner and thus the opportunity for substantial immediate tax savings would occur.

In the case of a principal residence transaction, the charity would want to ensure that if the donor and the spouse are going to use the property, that the donor contract to pay all costs in relation to the upkeep of the home. These would include the property and school taxes, insurance costs, maintenance costs and other costs associated with maintaining the home. The nature of the gift would be set out in a deed of gift evidencing the transfer of the property to the charity, evidencing the right of the donor and other specified individuals to use the properties for their lifetime and setting out the donor's responsibility for the costs of the upkeep of the home. It is noted that the gift provision could indicate that if the donor is still alive, he/she may have the right to have the house sold by the charity and replaced with another home to the extent of the proceeds received from the sale of the first residence. The donor would continue to live in the second residence for his/her lifetime.

EXAMPLE

Mrs. Schwartz, a widow, age 82 has decided to leave her condominium to the Jewish Community Foundation. The condo is valued at $350,000; the original cost was $200,000.

Assume the following:
Condo is a principal residence for length of ownership

Mortality (as per IT-112R2)	*9.4 years*
Discount rate	*7%*
Value of condo	*$350,000*

Present value of gift or residual value $185,293

Mrs. Schwartz will continue to live in the condo, or a replacement residence for her lifetime. She will pay all associated property taxes, insurance, maintenance costs.

She will receive, immediately, a receipt of $185,293, which can be used to save tax on her current tax return. Any unused receipt can be carried forward five years.

This type of gift can be achieved for other properties, e.g., artwork. The legal title to the artwork would be transferred to the charity, but the right of use for lifetime would be kept by the donor. In this case, the donor would be responsible for the maintenance and insurance costs. The value of the gift would be calculated in the same manner as above. However, due to the fact that artwork is taxable, any gain realized due to the residual transfer of the artwork would be taxable to the donor.

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11 Gifts of Capital Property

There are two components to a gift of capital property. The first is to determine the value of the property for the purposes of issuing a charitable receipt. The second is that one is deemed to have disposed of the capital property for proceeds equal to the value of the property.

This deemed disposition provision obviously will not have any effect where the cost base of the property equals the value. When this is not the case, the possibility of a capital gain arises. Fifty per cent of the capital gain is taxable. There are effectively two ways to offset the taxable capital gain, the first being to utilize the tax receipt against that income, the second via an election.

As discussed in the section on percentage limitations, the Income Tax Act does allow the donor to use the receipt to the extent of 75% of income created or 75% of any taxable capital gain created, plus an extra 25% of the taxable capital gain created on the transfer of property to the charity. Thus, 100% of the taxable income will be offset by the donation credit in the case of individuals or the donation deduction in the case of corporations.

Election

A method to avoid the capital gain on disposition is an election available under the Income Tax Act. Subsection 110.1(3) of the Act for corporations and subsection 118.1(6) of the Act for individuals allow the donor to elect his proceeds of dsposition for purposes of calculating the capital gain on the deemed disposition to be anywhere between the original cost of the property gifted and its fair market value. This had real value when the donation limits were only 20% without a bonus for capital gains realized on the disposition of the property to a charity. In these cases, it was very possible that the income added to a tax return could have been far greater than the donation receipt that was usable in the year. Therefore on a cash basis, taxes were paid in the year of the gift. With the new donation limits this situation should not occur.

There is no prescribed form for the election, which must appear in the donor's tax return in the year of the gift. An example - "Pursuant to Subsection 118.1(6) of the Income Tax Act (110.1(3) if the election is made by a corporation) I hereby elect that my deemed proceeds on the transfer of property to ABC Charity be __________." Note that the charity will issue the receipt based on the full value. Only the elected amount will be used to calculate the donation credit or deduction.

Capital Property in the Hands of the Charity

The new donation limit rules will, in some cases, make it preferable to donate capital property to the charity rather than selling the property, and donating the cash. The reason is the additional 25% of taxable capital gain donation limit. The donor should ensure, however, that the charity is capable of disposing of the property to receive the proper amount of proceeds. Often, the charity does not have the staff available and knowledge enough to deal with all aspects of the sale. Often, the donor should help the charity with the disposition to ensure that the ultimate gift is as high as possible.

Subsection 69(11)

When a donor transfers appreciated capital property to a charity, he/she might elect, under the provisions of subsection 110.1(3) or 118.1(6) to reduce the proceeds of disposition. Subsection 69(11) of the Act requires that where a taxpayer is taking advantage of a tax rollover to transfer property lower than at fair market value to a tax exempt entity, then it is necessary for that entity to hold on to the property for a three year holding period prior to sale. If the property is sold within the three-year period, then the presumed capital gain that was not realized by the donor or taxpayer on the original transaction would be realized at that time. This provision, subsection 69(11) could, on a technical basis apply to transactions where donors have elected for lower proceeds on disposition, due to the fact that a charity is a tax-exempt entity.

In discussions with the Office of the Minister of Finance, they indicated that they will not apply subsection 69(11) to a transfer of capital property where the 118.1(6) election has been made, unless they feel that the objective of the donation was not *bona fide*. This would be the case where property is transferred to a charity, an election to lower proceeds upon disposition occurs, and then the charity disposes the property back to the donor or to an entity which he/she controls. Another situation where subsection 69(11) might apply is where property is transferred to the charity and then the charity rents out the property to the donor or an associated entity. If one is planning a substantial transaction where the election will be used, one should check with CRA to ensure that subsection 69(11) is not applicable.

EXAMPLE

Mrs. Jann transfers capital property; land, to the Jewish Community Foundation. The original cost of the land was $80,000; the value today is $200,000. Mrs. Jann has an allowable capital loss carry forward available of $60,000.

Proceeds	*$200,000*
Cost	*80,000*
Capital Gain	*$120,000*
Taxable Capital Gain	*$60,000*
Utilization of Loss Carry forward	*(60,000)*
Taxable Income	*0*

Use of the Charitable Receipt

75% of net gain (75% of 60,000)	*$45,500*
25% of Taxable Capital Gain	*15,000*
	$60,000
Receipt Received	*$200,000*
Receipt Carried Forward	*$140,000*

**Note:* *If Mrs. Jann has no other income she would probably choose not to use the majority of the receipt. A charitable tax credit cannot create a tax refund; it can only reduce taxes payable to nil.*

Alternative Minimum Tax

Alternative Minimum Tax ("AMT") is an alternative tax calculation system to the basic calculation. The objective of AMT is to limit the use of special deductions that an individual may take to reduce his taxes payable. Thus, there are two sets of simultaneous calculations in a tax year. The first set calculates your income with all the normal deductions allowed under the Income Tax Act.

The second, the AMT one, calculates your income, allowing an annual $40,000 deduction, but disregarding many deductions allowed under the normal income tax return. The AMT tax rate is less than the normal tax rate and the end result compares the AMT tax liability to the normal income tax liability. If the AMT liability is higher, the individual actually pays the higher amount. Any overage of payment would be used in a following year as a tax payment wherever normal tax payable would be greater than AMT tax.

New provisions to the Income Tax Act will ensure that for gifts of capital property no adverse AMT results will occur. Consequently, the tax results under both calculations are identical.

Capital Dividend Account

If it is a Canadian corporation which has made a gift of capital property and a capital gain is realized, a portion of the capital gain is not taxed. If 50% of a gain is taxable then 50% is not taxed. (In the case of a gift of public company shares 100% is not taxed.)

The amount not taxed enters the corporation's Capital Dividend Account. Dividends paid out of the Capital Dividend Account are received tax-free by the shareholders.

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12 Gifts of Marketable Securities

The Federal Budget of February 18, 1997 created a new incentive for the gifting of marketable securities to charities. This incentive applies to gifts to private foundations and for Quebec tax purposes.

The provision acts to eliminate the inclusion for tax purposes of income realized by virtue of the disposition. Thus if a donor transfers shares of TD Bank to a charity a tax receipt equal to the value of the TD shares is issued. If the normal capital gain would be $80 given a value of $100 and a cost basis of $20, normally half of the $80 or $40 would be taxable. Under the new provision zero would be brought into income.

The provision is limited to securities listed on prescribed stock exchanges, which includes all of the Canadian stock exchanges, as well as stock exchanges in the U.S. and elsewhere. Mutual funds based on public securities are eligible.

EXAMPLE

Mr. Levin donates $100,000 of Royal Bank stock to the Jewish Community Foundation. His original cost is $50,000. His alternative is to sell the stock himself and donate $100,000.

	Stock Donation	Stock Sale
Proceeds	*$100,000*	*$100,000*
Cost	*50,000*	*50,000*
Capital gain	*$50,000*	*$ 50,000*
Taxable capital gain	*$25,000*	*$ 25,000*
Special exemption	*(25,000)*	*-*
Net income	*$ 0*	*$25,000*
Taxes payable 48%)	*$ 0*	*$12,000*
Tax receipt	*$100,000*	*$100,000*
Tax savings	*$48,000*	*$48,000*
Net tax savings	*$ 48,000*	*$36,000*

How to Transfer Marketable Securities

Generally, investors hold marketable securities in two forms. Either they have securities in their name or owned via a broker without the security certificate in their particular name. To gift a security certificate with the donor's name, the donor would endorse the security certificate and transfer it to the charity. Usually a local confirmation of the signature is required. A donation receipt will be issued for the value of the security at the date of the gift.

Most of the time, the securities are held in a brokerage account and therefore there is no need to transfer the actual certificates.

In this case the donor would direct his/her broker to transfer the securities into a new account in the name of the Federation/Foundation. The receipt will be issued based on the value of the securities transferred at closing. To set up an account in the name of the Federation/ Foundation the broker will probably have the Foundation/ Federation authorize the creation of the account.

Refer to the section on *Charitable Remainder Trusts* for an examination of using a trust to transfer marketable securities or other capital property to a charity in order to enhance current income of the donor. It is important to note that transferring marketable securities to a CRT will not be eligible for the reduced inclusion rate as a CRT is not a charitable organization, even if the charity is a trustee under the CRT.

Employee Stock Options. For shares acquired pursuant to an option after February 27, 2000 and donated in the same year and within 30 days after acquisition, the tax reduction will apply to both the capital gains and employment income realized.

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13 Gifts of Private Company Shares and Debt

THE NEW RULES

Non-Qualifying Security

The Act sets out a new methodology of taxation of gifts of private company shares and debt in circumstances where a "non-qualifying security" is gifted. The Income Tax Act defines a non-qualifying security as an obligation of the individual (or a person not at arm's length with the individual), a share issued by a corporation with which the individual does not deal at arm's length or any other security issued by the individual or non-arm's length person. Specifically exempted are obligations, shares and other securities listed on prescribed stock exchanges and deposits of financial institutions. Thus, a gift of private company shares where the donor or member of his immediate family - parent, spouse, child, controls, or as a group controls that corporation, would be considered a gift of a non-qualifying security. However, even many of these gifts will be exempted from the new rules.

Excepted Gift

An excepted gift is a gift of a share to an arm's length charity that is not a private foundation. The donor must be at arm's length with the directors and officers of the charitable organization or public foundation to which the gift has been made. Therefore, a gift to a public charity will be considered an excepted gift as long as the donor is not an officer or a director of that charity or if that donor is the parent, spouse or child of a director or officer of the charity. The preponderance of gifts of private company shares to public charities should not be affected by the new rules unless, of course, this non-arm's length provision comes into play. It would be necessary for a donor to resign from the board of the recipient organization prior to making the gift. This may be problematic as it is often the volunteers of a charity who feel most inclined to donate to that charity.

Gift of a Non-qualifying Security

If such a gift is made to a private foundation or, in some cases, to a non-arm's length public charity, then the gift will be ignored for the purpose of the charitable donation tax credit. This doesn't mean that the disposition for tax purpose hasn't occurred because it will have. If the charity disposes of the security within five years or if the security ceases to be a non-qualifying security of the individual in the five-year period, the individual will be treated as having made a gift at that later time. The disposition of the security could occur by the corporation redeeming the gift or buying back the shares from the charity for cash. For example, if the gift was 100 preferred shares worth $1 million and three years after the gift, the corporation redeems those shares for $1 million, and then the charity has disposed of the security. If instead, a donor "sells out" so that he is no longer at arm's length with the company, then the shares owned by the charity at that point would no longer be non-qualifying securities and, therefore, the donor would be deemed to have made the gift at that time.

The gift made at that later time will be deemed for purposes of the charitable donation receipt to be the lesser of two amounts - (1) the fair market value of the gift at the original transfer and (2) the fair market value of the shares at the time when the securities are no longer non-qualifying.

Reserve Mechanism

What appears as quite onerous rules are not quite so bad. First, when the original gift is made and perhaps a capital gain is realized, the taxpayer will be entitled to take a reserve against that capital gain. In essence, the reserve will continue to be taken on a year-in, year-out basis until, within the subsequent five year period, the gift will be deemed to be made because of a disposition of the non-qualifying security by the charity. Thus, if in year three, the security has been disposed of by the charity, the donor will be deemed to

have made the gift in that year. The original capital gain, reserved for the first two years, would be effectively taxable in year three as no reserve would be allowed then. However, the donation receipt would be available in year three to shelter the capital gain. Of course, one only has five years to dispose of the security and thus, it is possible that the gift will never be deemed to have occurred. Even in this case, the charitable tax consequence of having the taxable income, due to the disposition, realized without an offsetting tax receipt, will still not occur. The reason for this is that once the five year period is up, under the new reserve mechanism it would no longer be necessary to bring the reserved deduction back into income in year six. Thus, in essence, the capital gain would fall off the table never taxed just as the donor will never receive a tax receipt for the gift of shares.

Death

If within the five-year holding period, the taxpayer dies and the actual disposition of the non-qualifying security takes place after death, then it would appear that the realization of the gift will occur without the possibility of the deceased being able to use it on a tax return. Thus, this special provision has been enacted which will treat the subsequently resulting gift as having being made by the individual in the year of death rather than at the actual time of the disposition of the non-qualifying security.

Elections

The Income Tax Act allows a taxpayer to elect that his proceeds of disposition could equal an amount somewhere between his cost base of capital property gifted and the fair market value. This election is still available for gifts of non-qualifying securities and could be made either at the time of the original gift or at the time of the disposition of the non-qualifying security. Particularly in the Province of Quebec this election is key for Quebec tax purposes due to the lower donation limits but it may be that in estate planning situations where low-cost base shares are gifted to a private or public charity and there is no intention that the non - qualifying security be cashed in the foreseeable future that one would could elect out of the situation completely.

Loan backs

There is particular legislation dealing with loan backs. First, it is noted from the above review that a non-arm's length debt of a corporation is considered to be a non-qualifying security and an excepted gift does not include such a gift to a public or private charity. Thus, a gift of debt would be subject to the new rules and thus, the only way to receive a tax receipt would be if within the five year period the debt would be redeemed for cash.

The loan back situation is dealt with, where for example, an individual makes a cash gift and separately the charity holds a non-qualifying security of the individual within five years thereafter, and the charity acquired the security no earlier than five years before the gift was made. In this case, the gift of the individual will be reduced in value by the amount of the acquisition of the non-qualifying security.
For example, assume an individual makes a $100,000 gift to a charity and then a year later the charity loans $100,000 to a corporation not dealing at arm's length with that individual. Since the holding of the debt of the corporation has occurred within five years from the gift, the donation receipt issued by the charity on the original $100,000 gift must be reduced by the $100,000 that the charity paid to invest in the debt of the corporation. To deal with timing mechanisms, then if the charity purchased the debt prior to the gift, then this provision would also catch the transaction.

For example, if the charity loans a corporation $100,000 and subsequently (within five years) an individual not dealing at arm's length with that corporation, makes a $100,000 gift to the charity, then the receipt would be reduced by $100,000.

Where a gift is received by a charity and where the donor or non-arm's length person uses property of the charity within five years of that original gift, then the value of the gift will be reduced by the value of the property.

For example, if a gift of real estate is made and then subsequent to the gift the individual making the gift or his non-arm's length corporation uses the real estate, then even if it pays fair market rent, the value of the gift could be reduced.

APPLICATION OF THE RULES

Public Charities

It is clear that except for gifts of debt, the gift of private company shares is fully acceptable to public charities (charitable organizations and public foundations). The only difficulty lies with the special rule that the donor must be at arm's length with the directors and officers of the public charity. Of course, being a member of a Board of Directors of a charity does not constitute in itself the ability to control a charity.

However, the fact that a potential donor of private company shares is a member of the Board would, in essence, mean that the shares transferred would be non-qualifying security. Thus, it appears necessary that the Board member resign prior to the gift. If the charity still owns the shares five years after the original gift, then the donor can come back onto the Board of Directors at that point in time.

Note that it's not just the donor that may not be a Board member, but also anyone related to him/her including children, parents or spouse for purposes of the Income Tax Act. Also, the term that is used in the Act is "not at arm's length" which is more than simply family relations. It is a question of fact whether one does not deal at arm's length with another person or entity. Thus, if it could be shown that a donor controls the charity without being on the Board or has undue influence, then Revenue Canada may determine that such a donor does not deal at arm's length with the charity.

Private Foundations

The gifting to private foundations is not quite as liberal as it is for public institutions. A gift of a non-qualifying security itself does not result in an adverse tax result immediately or in the future due to the reserve mechanism. One may elect pursuant to Subsection 118.1(6), to ensure proceeds of disposition will not result in a capital gain. What is lost is the extra ability to use a donation receipt in excess of the taxable capital gain realized on the transaction. In the case of low cost base shares where effectively 50% of the value of the gift would be converted into a taxable capital gain, the loss would be the fact that 100% of the value of the shares would be subject to a receipt and, therefore, there would be a 50% loss in terms of extra credit available. In an estate planning situation with low cost base shares, the ability to roll these shares either intervivos or via will to the private foundation without adverse tax treatment, appears to be still quite beneficial.

High Cost Base Shares

With shares to be gifted with a high cost base normally one would expect that a full receipt would be useable by the donor and the resulting capital gain would be either non-existent or quite minor. In this case, the donor would expect significant tax savings. If these shares are non-qualifying securities, a receipt would not be issued unless the shares were disposed of within five year after the gift. It is in this particular case that the gift to private foundations would be limiting.

Reducing Cost Base

In the case of a non-qualifying security with a substantial cost base, one may wish to reduce the cost base prior to affecting the gift. Perhaps a reorganization of capital, a Section 85 transfer or a return of capital, allocating the cost base to non-share consideration would result in low cost base shares to be gifted tax effectively.

Assume an individual owns $2 million of preferred shares with a paid-up capital and a cost base of $200,000. It is intended that these shares be transferred to a private foundation. Prior to the gift, the company would return $200,000 of capital from these shares to the individual. Due to the paid-up capital and cost base of $200,000, no capital gain or dividend would result on the payment of the $200,000 to the shareholder.

The shareholder could decide to loan the $200,000 to the company. The preferred shares would now have a value of $1.8 million instead of $2 million, but would have a nil cost base. A gift of these shares to the public foundation would result in a non-qualifying security being gifted and, therefore, non-recognition of the gift. With an election pursuant to 118.1(6) or just the use of the reserve system for five years for the non-qualifying security gift, no tax would be payable on the transfer to the foundation.

EXAMPLE

If Mr. A gifts 50,000 preferred shares, worth $50,000, to a charity, and the company subsequently redeems the shares for $50,000 the following will occur:

Assuming a $50,000 cost base and a nil paid-up-capital Mr. A will receive a $50,000 charitable receipt which will save him $24,000 of tax.

Mr. A is $24,000 richer as it is the company which is remitting $50,000 to the charity via the redemption of shares.

Due to the low paid-up-capital, the redemption will result in a dividend to the charity. Of course the charity is exempt from taxation on its income. The dividend though is considered real to the payer corporation and it may be eligible for a dividend refund. (Note that if one of the main objectives of a transaction with a tax-exempt charity is to obtain a dividend refund, CRA has the right not to pay the refund. Beware of transactions where large dividend refunds are expected.)

***In summary** the corporation has paid $50,000 and the shareholder has received $24,000. Normally, via a dividend, the corporation would spend $36,900 in order for the shareholder to retain $24,000 after the payment of personal tax on the $36,900 dividend.*

***Thus**, for only an additional corporate cost of $13,100 a donation of $50,000 has been achieved. The "cost" of the donation is 26.2%. If a dividend refund is received on a dividend, then the cash outflow on the gift is nil.*

Super Capital Gains Exemption Shares

Legislation exists to exempt capital gains realized on the disposition of farm property and shares of companies have crystallized this exemption, effectively disposing of their shares and receiving back

These new shares are high cost base shares, albeit with low paid-up-capital. This low paid-up-capital would mean that on redemption of the shares, although no capital gain would arise due to the high cost base, a taxable dividend would result. Therefore these shares typically sit on the balance sheets.

If an individual gifts these shares to a public or private charity followed by a redemption of the shares he/she may have reduced the cost of the donation significantly.

Estate Planning

The advent of these rules does confirm numerous estate planning possibilities which could occur re the ownership of private company shares.

Consider a situation where an estate freeze has occurred whereby the second generation will receive common shares leaving the first generation with preferred shares of the company. Twenty years has passed and now the value of the new common shares is considerable and the holders of the preferred shares, the parents, are aged. If the company was worth $5 million at the time of the estate freeze, perhaps now the company is worth $15 million with the common shares owned by the second generation worth $10 million and the preferred shares $5 million. One of the parents has passed away and transferred the preferred shares to the surviving spouse. If this spouse were to pass away then the deemed disposition rules would operate such that the preferred shares worth $5 million would be subject to a tax upon death yielding a tax liability of perhaps $1.7 million.

Instead, a gift of these shares either prior to death or in the will to a charity would remove the tax liability. If the transfer were to a private foundation controlled by the family, then the shares would be non-qualifying securities and, therefore, it is probable that one would arrange so that no capital gain would occur but also no charitable donation receipt useable.

If the gift of the preferred shares were made to a public charity of which the family was dealing at arm's length, then the shares would not be considered non-qualifying and the donor would be entitled to a full $5 million charitable donation receipt (assuming the value of the shares are $5 million) and at the same time a taxable capital gain of 1/2 of the value or $2.5 million (assuming zero cost base) would be realized. The $2.5 million taxable capital gain would be sheltered by $3.75 million of the charity receipt with the balance of the receipt, $2.5 million, applicable against 75% of other income of the donor earned in the year or the subsequent five following years. If this gift had occurred in the will, then the extra $2.5 million receipt could be applicable against 100% of other taxable income created due to the death of the second spouse either because of the deemed disposition rules or the taxation on a RRIF on death. If no such other income will result, then it may be advisable to make the gift during lifetime so that the receipt can be useable against taxable income which could be created in the five following years after the gift.

By gifting to a public foundation there is obviously less control over the ultimate cashing in of the preferred shares. This is, of course, dependent on the attributes of the preferred shares. If the preferred shares are retractable, i.e. redeemable at the option of the holder, then the public charity would have the right to demand retraction at any time. Therefore, the family might create a shareholders' agreement limiting all the shareholders from demanding retraction of preferred shares. These gifts transferred to the charity then would be subject to the shareholders' agreement. This shareholders' agreement, though, might affect the value of these shares for the issuance of the donation receipt.

Conversion of Debt of Shares

One of the severe limitations of the new rules is the effective inability to claim a donation receipt for full cost base gifts of debt to charities whether public or private. Particularly in gifts to public charities where full cost base shares would entitle the donor to a full receipt, this inability to do the same with full cost base debt is limiting. However, one of the practical realities of holdings of shares and debt in a private company situation is that it is very easy to convert one into the other. For example, if one owned a $100,000 debt receivable from a company he controls, it is very easy to convert the debt into $100,000 of preferred shares which would hold a high cost base. After the conversion, one could donate the preferred to a public charity and receive a full tax receipt. The difference between gifting shares and debt is that for debt, the income that is paid to the charity subsequently would be interest expense of the payer corporation and often tax deductible. In the case of shares, the income that would be paid on the shares subsequent to the gift, dividends are not deductible to the corporation and, therefore, may not be as desirable.

There is nothing in the legislation which stops a company from converting its shares owned by a public charity into debt after five years from the original date of the gift. Therefore, the legislation does appear to allow for some manoeuvring either prior to the gift or after five years which could benefit the donors. Of

course one should weigh the possible application of the General Anti-avoidance Rules to these transactions.

Disbursement Quota

The gifting of shares to a charity does create value in the charity. The annual disbursement quota responsibility would be, simplistically 3.5% of the share value. Particularly in the case of a gift into a private foundation one must ensure that the company does pay out the proper amount of dividends to the private foundation to enable that foundation to spend 3.5% of its capital on an annual basis on charitable activities.

The rules in terms of disbursement quota are very similar for public charities and foundations and, therefore, the 3.5% rule must be accomodated. Of course, in a public charity there may be a vast array of assets in the public charity so that, in essence, the computations of disbursement quotas are merged together.

In other words, the disbursement quota is not on a gift-by-gift basis but on a charity-by-charity basis and, therefore, it may not be as necessary for a full 3.5% dividend to be paid in a public charity situation.

Valuation

Valuation of private share gifts is tricky and of concern to CRA. To issue receipts charities, especially for major gifts, should rely on valuation reports of qualified professionals.

Retract ability of shares; liquidity of the company, cumulative dividend rights, and many other factors will affect valuation. Thus, $2 million of preferred shares gifted to a charity may not be worth $2 million if the shares are not liquid nor subject to a market return. In an estate planning situation, where one of the hoped for results is the reduction of the tax liability on death, then valuation may not be important especially if the gift is of a non-qualifying security and a donation receipt is not expected.

EXAMPLE

Mr. Friedberg owns 1,000,000 preferred shares redeemable for $1 each. Their ACB and paid up capital (PUC) is nil as they arose in an earlier planned estate freeze.

Mr. Friedberg gifts 200,000 of the shares to the Jewish Community. He can elect pursuant to subsection 118.1(6) of the Income Tax Act that his proceeds of disposition be nil (his cost). Thus, no capital gain results. He will not use a charitable receipt, and therefore no tax benefit is achieved pursuant to the gift. However, to use the $200,000 receipt he will recognize the gain (50% taxable). On a net basis $50,000 is saved.

Mr. Friedberg and the Jewish Community Foundation will agree to a redemption schedule for the preferred shares.

If the family typically makes an annual donation to the Federation, the redemption schedule can effectively represent the family's annual donation for the period of redemption.

On death, Mr. Friedberg has the option of replacing the $200,000 of wealth gifted to the Jewish Community with insurance, probably purchased within the corporation.

Gifting intercorporate preferred shares

The focus on gifts of preferred shares is usually on the individual donor. Corporations can own preferred shares of each other. This gift of intercorp for corporations.

Consider Corporation A has realized $1 million of taxable income and wishes to eliminate the tax on this income. It purchases $1 million of preferred shares of Corporation B, another company in the group. Subsequently, it gives the share of B to a public charity. The charity issues a $1 million receipt to A (assuming a valuation has confirmed the value.) If, for example, the preferred shares are 5% cumulative, corpus B would remit $50,000. An annual dividend to the charity (the dividends are not taxable to the charity, but are considered "taxable dividends" paid by B.

The numbers here work very well to create philanthropy in a tax and financially-efficient manner.

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Conclusion

The gifting of private company shares (but not debt) is alive, but if not 100% well, should be a major area for development in the near future.

What is clear is that the parameters surrounding a gift of shares is much more complicated than other gifts. It is cautioned that proper legal and accounting advice be sought from both the point of view of the donor and the charity when these gifts are affected.

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15 Gifts of Real Estate

Generally, an outright gift of real property to a public charity entitles the donor to a charitable contribution deduction or credit equal to the fair market value of the property. There are estate-planning possibilities in the transfer of real estate to a charity and these possibilities are examined in the chapter on individual estate planning. For the most part, what makes the gifting of real property a little more complicated is the special tax effects.

There are two tax aspects upon the sale or gifting of real estate. The first is the calculation of capital gain on the property whereby the proceeds upon disposition or the deemed proceeds of disposition upon the gift will be compared to the original cost of the depreciable property or of the land to determine if there is a taxable gain realized. The second part, which is a bit more complicated, is that depreciable property is, through its life treated as a business asset, depreciated (capital cost allowance is taken on it) in order to reduce annual net income from the property. Thus, on an annual basis, the original capital cost of depreciable property is reduced by capital cost allowance and every year a new undepreciated capital cost is formed. Upon sale, death, or gifting any capital cost allowance which was taken is reversed, if the proceeds of the disposition are greater than the undepreciated capital cost at the time of the tax transaction.

For example, if a building which originally cost $100,000 was depreciated so that its undepreciated capital cost was $60,000 and if the sale or gift is valued at $120,000, there would be two separate tax transactions. The first is to compare the proceeds to the original cost of the building, $100,000. A $20,000 capital gain would be realized. The next would be to take the original cost $100,000 and compare that to the undepreciated capital cost of $60,000 and, $40,000 of recapture will be realized. Whereas 50% of capital gains are taxed, 100% of recapture is taxable. For Federal purposes a donation receipt can be used to offset all of the capital gain and all of the recaptured depreciation.

EXAMPLE

Mr. Cohen wishes to donate an apartment building to the Jewish Community Foundation. The building was purchased in 1975 for $300,000. ($270,000 is allocated to building and $30,000 to the land.)

Today the value of the building is $1,000,000 of which 20% is allocated to land. The undepreciated capital cost (UCC) of the building is $50,000.

Charitable Gift Receipt $1,000,000

Tax Effects

	Land	Building	Taxable Income
Disposition	$200,000	$800,000	
Original cost	30,000	270,000	
Capital gain	$170,000	$ 530,000	$700,000
Original cost		$ 270,000	x 50%
UCC		50,000	$ 350,000
Recapture		$220,000	$ 220,000
Total taxable income		$ 570,000	

Donation Limits

Charitable gift receipt	$1,000,000
75% of income (75% x $570,000)	$427,500
25% of Taxable capital gain	
(25% x $350,000)	87,500
25% of Recapture (25% x $220,000)	55,000
Receipt Used	$570,000
Available for carry forward	$ 430,000

15 Gifts of Art

There are two distinct tax mechanisms for gifts of art. One involves a gift of Canadian cultural property which is governed by the Canadian Cultural Property Review Act of Canada. Where these art pieces are donated the gift will not result in a disposition for tax purposes and therefore, no capital gain will be realized. The donation receipt at value is useable against 100% of income. In the Federated system, there is

usually not much opportunity for a donation of Canadian cultural property although it could occur for manuscripts or antique books gifted to a Jewish Public Library or suitable gifts to a Holocaust Museum.

Most art donations made within the Federation/Foundation system would not be subject to the Canadian Cultural Property Review Act and would be subject to the normal disposition rules for capital property. Thus, capital gains will arise on disposition and a full donation receipt will be received for the value of the art. *Bona fide* appraisals must be done in order to issue a proper donation receipt. It is noted that, unless part of a business, art is considered personal use property for the purposes of the Income Tax Act. This means that although capital gains will still be taxable, capital losses arising from the disposition of personal use property cannot be applied against other capital gains, only against capital gains arising from personal use property.

Another rule which one may take advantage of is that personal property, regardless of the cost or fair market value, is deemed to have proceeds of a minimum of $1,000 and a minimum cost base of $1,000. Therefore a gift of art that is valued at $1,200 which costs $500 would be deemed to have a cost base of $1,000 and a $200 capital gain would result. Although this may not be significant, some taxpayers own vast collections with numerous pieces of art e.g. etchings, where the value of each piece is not great, but the value of the entire collection is substantial because of the numerous pieces. Using this deemed $1,000 adjusted cost base can create a situation where no or very little capital gain is realized but the donation receipt received is based on the value of the property. Note that although deemed proceeds are a minimum of $1,000 for personal use property, if the value of the property is only $600, the donation receipt will only be $600.

EXAMPLE

Mr. Moscovitz wishes to give five pieces of art to the Federation. Values and original costs are described below.

Artwork	***Value***	***Cost***	***Deemed Proceeds***	***Deemed Cost***	***Capital Gain***
#1	*$3,000*	*$2,000*	*$3,000*	*$2,000*	*$1,000*
#2	*$4,000*	*$ 500*	*$4,000*	*$1,000*	*$3,000*
#3	*$ 800*	*$ 900*	*$1,000*	*$1,000*	
#4	*$ 900*	*$ 100*	*$1,000*	*$1,000*	
#5	*$ 500*	*$ 100*	*$1,000*	*$1,000*	
	$9,200			*$4,000*	

Charitable Receipt *$9,200*

Taxable Capital Gain
(50% x $4,000) *$2,000*

However, the $1,000 deemed ACB and deemed proceeds of disposition will not apply for property acquired after February 27, 2000 as part of an arrangement in which the property is donated as a charitable gift.

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16 Individual Estate Planning

Canada does not levy succession duties. However, its Income Tax Act does provide for deemed dispositions on death of the individual's assets. Taxation on deemed disposition is left for the second death. There is a tax rollover for assets left to the spouse. Disposition is particularly onerous for those who hold real estate as not only taxable capital gains will be realized but also recaptured depreciation.

Further, the value of RRSP's not yet matured or RRIF's will be brought into the tax return on death which can also result in an onerous tax. Please refer to the chapter on *RRSP Gift Planning.*

There are two major factors which contribute to the merger of gift planning and estate planning. The first is that the Income Tax Act provides for a donation limit of 100% on death. Donations can be utilized to offset 100% of the income on the final tax return which is dated at the date of death and 100% of the income realized in the year prior to death.

The second key factor is the provision which allows a taxpayer to treat donations set out in his/her will as donations effectively paid in the year of death. This creates some powerful planning as it is not necessary to create an actual donation in the year of death (which is very hard to plan). One can set out a testamentary charitable intent in a will which will mean that the donation would be paid sometime after death, but still save tax on tax returns dated at death and before.

Wealth Replacement Life Insurance

The insurance technique can be worked in reverse. If appreciated assets are owned which do not need to be maintained in the family the asset can be gifted to the Jewish Community pursuant to the will. Insurance can be purchased to replace the asset for the benefit of the family.

EXAMPLE

Mr. and Mrs. Cohen, age 60, own a Chagall painting which they are very proud of. Purchased 20 years ago for $25,000, it is now insured and valued at $500,000. They would like to bequeath the asset to their child, Henry, and hope that the family will always own the painting.

Deemed proceeds on death	*$500,000*
Cost base	*25,000*
Capital gain	*$475,000*
Taxable capital gain	*$237,500*
Tax payable at 50%	*$118,750*

Mr. and Mrs. Cohen provide in their wills that the last to die will bequeath to the Jewish Community Foundation a gift of $237,500.

They purchase a life insurance policy (with the estate as beneficiary), a last-to-die policy with a face value of $237,500.

The insurance premiums will cost $36,000, $6,000 a year for 6 years.

On the second death the donation receipt from the Jewish Community Foundation will offset the taxable capital gain on the transfer of the painting to Henry. No tax will be paid.

The estate will receive tax-free insurance proceeds which is transferred to the Jewish Community Foundation to fulfil the gift obligation set out in the will.

The Jewish Community will receive a terrific gift of $237,500 to memorialize the Cohens. The effective cost of this gift of $36,000 is far less than the potential income tax liability.

EXAMPLE:

Mr. and Mrs. Cohen own a vacation condominium (acting as a second residence) valued at $500,0000. Its original cost was $100,000. They have three children; none of whom would like to keep the property. They prefer cash.

In their will, on a last-to-die basis, the Cohens bequeath the property to the Jewish Community Foundation.

The Cohens purchase a last-to-die insurance policy for a face value of $500,000.

On death the gift receipt issued by the Jewish Community Foundation will more than offset the taxable capital gain realized upon death, In fact, the excess receipt can reduce other taxes payable.

The estate - and therefore the children -will receive $500,000 of cash, free of tax. Again the family will receive greater after tax proceeds and a terrific gift for the community has been realized.

Utilizing the Corporation

If insurance is to be used to fund a gift to the community or to replace other wealth gifted by the family, the corporation may be the best place to hold and own the insurance policy.

Insurance proceeds on death are received tax-free by the corporation but are not included in the value for deemed disposition purposes on death of the shares of the company. Upon receipt, the insurance proceeds can be flowed-through to the beneficiaries tax-free via the capital dividend account, created by virtue of the insurance proceeds. An examination of corporate and estate planning techniques is found in the chapter under that name.

Spousal Trusts

If appreciated assets containing an inherent tax liability are to be transferred to beneficiaries on the spouse's death, then it may be possible to turn a spousal trust into a charitable remainder trust. By creating a spousal trust, without the ability for spousal capital encroachment, and with the capital beneficiary the Foundation/Federation, no tax will be payable on the assets ultimately gifted and the creation of the charitable remainder trust may yield a tax receipt which can shelter taxable income created due to appreciated assets left to non-spouses.

Summary

The objective of, combining estate and gift planning is to recognize the potential for tax, and using gift planning to reduce the tax bill while making a gift. The planning will only work with charitable intent. One can replace tax liability with donations, but in the end the gift will reduce family wealth, even if the "cost" of the gift is reduced by the planning.

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17 Corporate Estate Planning

EXAMPLE

Mr. Feldman, age 68 wishes to leave the shares of his active company to his two children currently running the business. The other value within the estate, capital investment assets totalling $3,000,000 will be placed in a spousal trust, the capital beneficiaries of which will be the children. His wife, Edna, age 67, will be entitled to encroach on the capital during her lifetime. The active company shares have a cost base of nil and are worth $1,000,000.

Proceeds of Disposition	*$1,000,000*
Cost	*nil*
Capital Gain	*$1,000,000*
Taxable Capital Gain	*$ 500,000*
Tax at 50%	*$ 250,000*

Mr. and Mrs. Feldman purchase a last-to-die insurance policy for a face value of $1,500,000. The cost of this policy is $180,000 payable at for over six years.

Mr. Feldman sets up two spousal trusts in his will for $1,500,000 each. The first is a normal spousal trust allowing Mrs. Feldman full encroachment, and the children as capital beneficiaries. The second has no capital encroachment possibility and the capital beneficiary is the Jewish Community Foundation.

On death, the $500,000 capital gain will be offset by the donation receipt issued by the Foundation. What will this receipt be? It depends when Mr. Feldman passes away. The trust is, in fact, a charitable remainder trust, and this receipt will be issued based on the $150,000 value, Mrs. Feldman's mortality and discount rate at that time.

If Mr. Feldman were to die in 10 years, and based on a mortality of 11 years for Mrs. Feldman, and assuming a 7% discount rate, a donation receipt of $760,000 would be issued which will offset the taxable capital gain on the shares.

Upon Mrs. Feldman's death, the Jewish Community Foundation will receive $1,500,000 of capital from the second trust and the children will receive $3,000,000, $1,500,000 from the first trust (as long as capital was not encroached) and $1,500,000 tax-free via the insurance policy.

A terrific donation has been made at a cost less than the tax liability.

Corporate Shares

The shares of private corporations remain one of the largest potential causes for capital gains estate taxes. Further in this chapter we will examine methods to reduce the value of these shares.

Alternatively, in some situations we might consider an outright gift of the shares. For estate planning purposes one might consider the gift of preferred shares with a low cost base in order to avoid the death tax on the shares. This topic is described in the chapter on Gifts of Private Company Shares.

The Private Company

The ability to pay tax-free intercorporate dividends, the tax deferral and the corporate limited liability have led to the frequent use of private companies in Canada. Owners of operating companies (OPCOS) wishing to protect excess earnings transfer the ownership of their shares in OPCOS to newly incorporated companies which became the parent companies of the OPCOS.

These holding companies (HOLDCOS) received tax-free dividends from the OPCOS. The movement of wealth to the HOLDCOS allowed for a separation of assets from the OPCOS. If ever a business setback would occur in OPCO, wealth would still be kept separate in HOLDCO. Usually HOLDCO was used for diversification perhaps holding real estate or investing in the stock market. Wealthy Canadians have their wealth tied up in these companies, not necessarily similar to the US situation.

The Tax Problem

Unlike the US, Canada does not impose succession taxes. However, the Income Tax Act does impose a deemed disposition of assets upon death. This disposition results in tax paid on assets which have appreciated in value over the course of ownership by the deceased. The

basic exception to this disposition occurs if the assets in question will be transferred to the spouse or a spouse trust. Thus, tax is imposed on the death of the second spouse. Since many Canadians maintain their wealth within HOLDCOS. The advantage of tax deferral comes full circle upon death. All that value within HOLDCOS and OPCOS becomes taxable. The generation that amassed incredible wealth in the 60's, 70's and 80's, as they pass away, will be left with huge tax bills. Can our Canadian charities recognize the problem and offer to meet the needs of this generation?

The Theoretical Solution

The key lies in how the Act reads in prescribing when to calculate the deemed disposition. The Act prescribes that the deceased be deemed to have disposed of his/her assets immediately prior to death. The proceeds of disposition is "equal to the fair market value of the property immediately before the death". The solution would therefore be to reduce the value of assets before death and to replace the capital with assets received after death. The charity will help the donor reduce the value of assets prior to death and insurance will be used to replace the capital after death.

Insurance proceeds received upon death are received tax-free. If a corporation owns a policy upon the deceased, the proceeds from the policy will not be included in the value of the deceased’s shares for deemed disposition purposes as the policy is not payable immediately prior to death. If cash surrender value (CSV) is attached to the policy, this CSV will be included in the value of the shares for deemed disposition purposes.

A gift to the Jewish Community from the company during the donor's lifetime will reduce the value of the shares upon death. Replacing the gift with insurance will convert a taxed asset on death into a non-taxed one, as described in the following example.

EXAMPLE

Mr. Caplan owns Company M, a holding company used to own a diverse group of assets. Its value is $10,000,000. His shares have a nil ACB and the company earns $500,000 a year. On death, Mr. C's estate would remit capital gains tax on the $10,000,000 value.

Co. M donates $1,000,000 to the Jewish Community Foundation ($250,000 a year for four years). Over the four-year period, the company will save over $400,000 of tax.

With a portion of the tax savings, Co. M purchases a $1,000,000 insurance policy on the life of Mr. Caplan (premiums costing $60,000 per year).

Results

(1) A $1,000,000 gift is made to the Jewish Community Foundation from which the Foundation will make Mr. Caplan's charitable gifts for the rest of his life. Assuming a 7.5% return, the Foundation will make $75,000 of donations annually, based on the advice of Mr. Cohen.

(2) A net profit will result equal to the tax savings less the insurance premium cost.

(3) One million dollars is removed from the company reducing its value for purposes of deemed disposition on death.

(4) A million dollars of insurance proceeds are received after death tax-free (and not included in the deemed disposition except for the cash surrender value of the policy).

(5) The beneficiaries receive the insurance proceeds personally tax-free to the extent of the capital dividend account created by the life insurance proceeds.

Insured Annuity

The theory is to reduce the value of the company during the lifetime of the shareholder to be replaced by insurance received after death. The Insured Annuity concept was reviewed in an earlier chapter. This should be considered in corporate estate planning.

The purchase of an annuity on the life of the shareholder will reduce the value of the company. Replacing the value with life insurance will create an estate planning advantage. The annuity is defined to be a life insurance contract. In the absence of cash surrender value the economic value of the annuity will not be included in the value of the shares at death.

Note that the taxation of annuities in a corporation is calculated differently than if an individual receives an annuity. An individual will be taxed annually on the same amount. The corporation's taxable element of the annuity will vary over time as the corporate system follows the financial effect of an annuity more closely. Whatever the taxation, the effect for estate planning in the corporate setting is positive.

In summary, after-tax income is maintained, capital is maintained for the family, estate taxes are saved and a large endowment is gifted upon death.

EXAMPLE

Company M has $1,000,000 earning 7% annual interest. After tax 3.5% is earned. Mr. Caplan has Company M purchase an annuity with $1,000,000 of cash. An annuity of $100,000 a year will be received by Company M for the rest of Mr. and Mrs. Caplan's life. Company M purchases a last-to-die policy on the lives of Mr. and Mrs. Caplan.

On the death of Mr. and Mrs. Caplan, the value of the shares of Company M have been reduced by $1,000,000, although the amount will be replaced by the receipt of the tax-free insurance proceeds. Further, the amount will be passed to the beneficiaries without tax via the capital dividend account.

Annual annuity receipt	*$100,000*
Tax on income element of annuity	*(12,000)*
Cost of annual insurance premium	*(40,000)*
After tax income to Company M.	*$48,000*
Previous after-tax income	*$ 35,000*

Mr. Caplan has achieved an exciting estate tax savings. With the additional annual income of $13,000, Company M purchases another last-to-die policy on the lives of the Caplans with a face value of $625,000.

The beneficiary of the policy is the Jewish Community Foundation. The cost of the premium of $25,000 will be tax deductible leaving an after-tax cost of $13,000.

Insurance

If a corporate insurance policy is treated as an investment the estate gift planning possibilities are extended.

EXAMPLE

Mr. Bercovitch has his corporation purchase a universal insurance policy as described below.
The premiums are $180,000 a year for three years or $540,000.The policy is set to pay a death benefit of the premiums plus a 4% return plus $500,000.

On death the premiums are repaid/cashed in and if the death occurs in say 20 years $1,571,000 will be received evidencing a 4% after-tax investment. In addition $500,000 will be received tax-free by the corporation which will be used to fund a gift to the Jewish Community Foundation.

This gift will be paid in one of two ways. Either the company will make the $500,000 gift and receive the charitable receipt, or alternatively, Mr. Bercovitch will set up a $500,000 gift in his will. The company will declare a $500,000 dividend to the estate out of the capital dividend account created by the insurance proceeds. The dividend will be received tax-free and the estate will have $500,000 to pay the Foundation gift. Thus, Mr. Bercovitch's final tax return will contain a $500,000 receipt applied 100% against other income.

Subsection 164(6) and Will planning

A basic corporate estate planning strategy has been to have the corporation take out a policy on a shareholder. On death, the deceased's shares are redeemed by the company funded by the life insurance proceeds. In effect the capital gain in the deceased's return is replaced by a dividend to the estate which is non-taxable as the dividend is elected out of the capital dividend account arising from the life insurance proceeds. The Income Tax Act has been amended to reduce the capital loss to the estate upon the redemption of shares, which by virtue of subsection 164(6) is carried back to offset the deceased's capital gains to simplistically 50% of the dividend. Consider utilizing the 50% opportunity and make a will gift to double the tax savings.

In summary, on a net basis the 164(6) carry back using insurance will save about $1m of tax and the same insurance proceeds funding the gift will save a further $1.5m. The cost-the insurance premiums paid by the corporation.

EXAMPLE

Mr. Aaron's shares of Aco are worth $12m. Aco takes out a $3m policy on Mr. Aaron's life. Mr. Aaron's will provides for a discretionary gift to the JCF for up to $3m.

On death Mr. Aaron's final return will indicate $6m of taxable income due to the deemed disposition of Aco shares. The Estate's shares in Aco are redeemed for $3 cash (funded from the life insurance policy) and a $9m stock dividend of non-voting full ACB and PUC preferred shares.

The redemption creates a $12m dividend to the estate of which $9m is taxable as Aco elects $3m out of the CDA account created by the insurance proceeds. In addition, a capital loss of $12m is incurred which by virtue of subsection 164(6) is carried back to Mr. Aaron's return to eliminate the capital gain. The estate pays the gift to the JCF. As the will gift is discretionary the donation receipt is used by the estate and not the final return (see chapter on Bequests).

18 Departure Tax Planning

Overview

Canada taxes individuals on the basis of residence and consequently every person residing in Canada is taxed on their worldwide income.

Where an individual ceases to be a resident of Canada, the Income Tax Act levies a "departure" tax in an attempt to ensure that Canada receives its fair share of tax revenue on income earned while resident. The departure tax is, for the most part, aimed at taxing the appreciated value of capital property which grew in value during residency.

The departure tax is computed by deeming an individual to have sold at fair market value their capital property immediately before ceasing to be a resident. One either pays the resulting tax or elects to defer the payment of the tax until actual disposition by depositing security with the government.

There are assets which were exempted from the rule, namely taxable Canadian property (TCP). Most Canadian assets were considered to be TCP including Canadian real estate and private company shares. Simply stated, what was caught was marketable securities.

On October 1, 1996 the Federal Minister of Finance announced a significant change to the exempted assets. As of departures after October 1, 1996, shares of private companies will now be subject to departure tax and thus subject to cumulative tax payment or the posting of security, with CRA having the discretion to determine the form of security and the amount thereof.

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Gift Planning

The inclusion of private company shares in the departure tax net will have significant effect on Canadians contemplating giving up residency and in some cases will result in residency being maintained.

EXAMPLE

One can envision situations where the combination of estate, gift and departure tax planning may enable a Canadian to achieve his or her objective.

Consider a situation in which Mr. A age 70 wishes to retire to the Bahamas. Mr. A owns shares of a private company, OPCO, which his children now run. In 1980, an estate freeze was effected whereby Mr. A's common shares of OPCO were exchanged for preferred shares, with new common shares issued for nominal value to the children.

Today the common shares of OPCO are worth $10,000,000 and Mr. A's preferred are valued at $2,000,000. The potential departure tax liability is $480,000 (assuming an nil ACB).

Prior to departure Mr. A gifts his preferred shares to the Jewish Community Foundation. He elects pursuant to subsection 118.1(6) of the Act that the disposition occur at cost to ensure no capital gain be realized. No receipt will be useable (See Gift of Private Company Shares and Debt Chapter to determine if the receipt can be used without the election).

The Jewish Community Foundation and OPCO agree on a timing formula for redemption of the preferred shares. Perhaps OPCO will purchase $2,000,000 of insurance on Mr. A's life, the of which will fund the redemption. Perhaps the redemption will fund the annual Federation gift of the family. Perhaps a special community project is endowed in the name of Mr. A.

The net effect of the plan is to delay or eliminate the departure tax or the security posted to CRA. The estate-planning concept is that the family has in essence reduced the value of an asset that would have been taxed on Mr. A's death. Scheduling the redemption to coincide with the family's annual Federation gift effectively increases the value of the children's common share at the expense of the preferred, thus moving the estate tax ultimately to the children's level.

Departure Tax Gift Planning is not for everyone. It does underscore the principle that it is important to consider one's charitable gift options as part of one's financial and tax planning in order to meet one's financial, life and charitable objectives.

**Note: For a more complete review of the departure tax legislation please refer to "Tax Issues in Being a Non-resident of Canada" by Mark D. Brender*

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19 RRSP Gift Planning

Canada's individual income tax system is premised on an annual calculation of income. Thus, salaries earned in the year, dividends received in the year, interest income earned in the year or dispositions of property within the calendar year are all taxed in the year. There are exceptions to this rule, in effect, government sanctioned tax shelters or tax deferral mechanisms. These include Registered Pension Plans, Registered Home Ownership Savings Plans, Deferred Profit Sharing Plans, Registered Education Savings Plans, Registered Retirement Savings Plans ("RRSP's") and Registered Retirement Income Funds ("RRIF's"). Income earned within these registered plans are not taxed annually, but are allowed to accumulate as long as the funds remain within the plan.

RRSP's and RRIF's contain billions of dollars and are potential sources of donations. They also contain potential tax liability.

The objective of this chapter is to briefly review the mechanics of these plans to understand when tax consequences do arise and then to determine if charitable giving plans can be adapted to benefit the taxpayer and charitable institutions.

Registered Retirement Savings Plan

A Registered Retirement Savings Plan ("RRSP") is a registered plan, operated privately by a Canadian. Its objective is to allow an individual Canadian to create his or her own pension where the ability to have an employer contribute to a Registered Pension Plan ("RPP") is not available. In this way, contributions are made annually into the plan at the complete discretion of the individual with an aim of building up the plan so that at retirement age, a pension can be purchased by the plan for the individual. The earnings within the plan accumulate free of current tax and thus, the amount in this fund can grow quite rapidly.

The maximum limit for annual RRSP contributions is $21,000 or 18% of earned income. One is entitled to contribute to an RRSP until the age of 71. If one does not contribute the full entitlement in a year, the balance can be contributed in a future year when he/she can afford the contribution and deduct it in that year.

Once a taxpayer attains the age of 71, he/she either brings the amount in his RRSP into income or purchases a registered investment which delays the realization of income. Simplistically, there are two options or a combination of these options which a taxpayer can take advantage of. The first one is to purchase a life annuity. A life annuity is basically a set pension for lifetime and it is possible to purchase such an annuity whereby the spouse can continue to receive the pension even if the annuitant passes away. Often, a guaranteed period is attached to the life annuity, so if the annuitant and his/her spouse pass away within the guaranteed period, then the estate would continue to receive the annuity for the balance of the period.

The other general option available to a taxpayer is a Registered Retirement Income Fund or ("RRIF"). Based on the original conceptualisation of a RRIF, a life annuity is not purchased but instead, payments will be received out of the RRIF over a 19-year period. Smaller payments are received up front but these payments grow as the 19-year period continues. Recent legislation has created many variations to the RRIF, including life annuity options and, therefore, there are many options to the payment possibilities. The RRIF is often chosen as an option because the realization of income is deferred and thus taxation is delayed. If payments are delayed and if the annuitant passes away, there are often significant funds within the RRIF which are turned over to the estate at death that become taxable at that time.

The key change to the RRIF is the ability to maintain an RRIF forever. Previously, after 19 years the RRIF was fully retrieved by the holder with associated tax paid. Now the plan can be continued indefinitely, although if the taxpayer is in his/her nineties, he/she must remove a minimum of 20% of the value of the assets annually. Therefore, at death there is a great possibility for value in the plan.

Charitable Donations

There are no particular provisions in the Income Tax Act which combine charitable giving and deferred plans. The planning is not a question of legislation, but of logic. The logic being to marry-up the possibility of income inclusion to the possibility of charitable giving and thus a corresponding tax credit.

For most Canadians, the creation of a Registered Pension Plan is a meaningful mechanism to create retirement income. This is not necessarily the case for RRSP's; as for some Canadians their retirement funding is secure regardless of RRSP contributions. A basic premise of an RRSP is that one receives a tax deduction, presently up to $20,000 a year for contributions. A taxpayer earning significant income who does not need all those dollars for living expenses is often suggested to make a contribution to an RRSP to defer tax and to allow for a tax-free accumulation of income within the RRSP. In essence, it is partially the government's money which is growing and accumulating for the taxpayer which creates a terrific investment vehicle regardless of the pension objective.

The mental framework for many Canadians is that it is not a pension gathering tool but a tax deferral device. The meaning of this is that at the time when the dollars are available to come out or must be taken out at age 71, these dollars may not be needed for the lifestyle of the individual but instead create a tax problem.

EXAMPLE 1

Anticipated RRIF value on death	*$500,000*
Potential tax liability	*$250,000*
Cost of premiums over 6 years to purchase a $500,000 life insurance policy to be gifted via the will	*$120,000*
Net Savings	*$130,000*

The $500,000 RRIF income on death will be offset by the $500,000 gift. No tax will be paid. The cost of the insurance is less than the ultimate tax cost; however, the true value of money is not calculated in this example.

Further, the anticipated RRIF value is questionable. How does one know when one dies? However, this planning is possible to reduce taxes generally on death, whether the taxes arise due to RRIF's or appreciated property or both.

Consequently, in the cases of RRSP and RRIF's, there are thousands of Canadians who have significant dollars in these accounts who may not need the funds either personally or for estate planning purposes. These dollars could very well be available for charitable purposes given that these amounts are taxable and a corresponding charitable tax receipt would be valuable.

Pension Annuity or RRIF Payments

If the taxpayer is in receipt of a pension annuity or RRIF payment, then these amounts are taxable. If the amounts are not needed for lifestyle purposes, a program of transfer to a charity will effectively allow for an offset of the income against the tax donation. For example, a $1,000 taxable annuity, at a 48% tax rate would leave the individual with $520. A transfer of that $1,000 of income to a charity will allow the tax credit to offset the income inclusion from the annuity so that no tax is paid.

RRSP and RRSP Gifts to Charity

For deaths occurring after 1998 the donation's tax credit on the final tax return will be available, both for these gifts made via the will or for RRSP, RRIF and insurance proceeds made through direct beneficiary designations.

This 100% limit is important for taxpayers in their planning as it allows for a very easy methodology of reducing significant taxes on death. Caution is called for if an individual wishes to transfer the value of his/her RRSP or RRIF within the course of his lifetime. Unlike a donation of capital property, whereby a taxpayer can elect a disposition at any amount between his cost base and the fair market value, no such provision exists for the transfer of RRSP's or RRIF's. These trusts, for these purposes, will not be considered to be capital property and, therefore, the election cannot be made. Further, there are no increased donation limits for transfers of these trusts unlike capital property. Thus, a transfer of a lump sum payment during lifetime will result in an equal donation receipt to the income recognition but the donation receipt can only be used against 75% of the income of the donor. It is possible that the lump sum payment may carry some taxation which is not sheltered by the donation receipt. On the other hand, if the individual is in a situation where say he/she's transferring a $100,000 RRSP to a charity, but has $75,000 of other income, the charity receipt of $100,000 will be fully usable against income of $175,000 based on the 75% test. The expanded donation limit rules moving from 20% to 75% does allow for a new thought process for the transfer of an existing RRSP to a charity.

Utilizing the 100% donation limit on death, in contemplation of income recognition on death due to a RRSP or RRIF, may lead to a different style of planning. If one anticipates, say a $500,000 RRSP income inclusion on death, this would result in a $240,000 tax liability. A $500,000 charitable donation receipt could be used to eliminate the tax liability. One mechanism to achieve this credit is to purchase life insurance to fund a gift on death. As the RRSP income inclusion would occur after the second death, one would purchase a last to die policy so that the gift, set out in the will, would occur at the same time. The cost of the insurance is often far less than the ultimate tax liability. The family is, in effect, using the government's tax money to fund the charitable gift.

It is clear that there are billions of dollars invested annually in RRSP's and further billions of dollars earned within RRSP's on a tax-free basis annually. It is an incredible amount of relatively liquid assets, which makes it a fertile ground for gift planning for charities.

Lastly, it must be pointed out that the above review is based on Federal tax law, i.e. donation limits of 75% of net annual income and a donation limit of 100% upon death.

EXAMPLE 2
RRIF Cash-in

Mr. Schwartz has always wanted to cash-in his $500,000 RRSP but he does not want to pay the heavy tax. He has made a special gift to the Community of $500,000. His annual income is $100,000.

Income	*$100,000*
Add: cash-in of RRSP	*300,000*
	$400,000
Use of receipt	*$300,000*

Instead of creating a large charitable carry forward, Mr. Schwartz has cashed in his RRSP's.

EXAMPLE 3

Mr. Jones donates $10,000 of Royal Bank stock to the Community. Cost base is $2,000. He wishes to cash in his RRSP's.

Value	*$10,000*
ACB	*2,000*
Gain	*$ 8,000*
Taxable	*$ 0*
RRSP cash-in	*10,000*
Taxable income	*$100,000*
Charitable receipt	*$10,000*

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Private Foundations and their Alternatives

Introduction

Many charitable foundations, established by individuals and families for the support of charitable educational objectives, may not be the ideal solution to an individual's or a family's long term charitable goals. Such foundations are generally classified as private foundations under the law and as such, are subject to restrictions and increased cost of operations which may adversely affect the donor's long-range charitable opportunities.

Under the tax laws, charitable organizations are generally divided into two categories: private foundations and public charities. Public charities will either be charitable organizations, such as Federations, or public foundations such as the Jewish Community Foundations ("JCF").

The basic premise of a private foundation is that it is controlled by small related group of donors, rather than the public foundation which is controlled by a diverse group of, in essence, community volunteers.

Restrictions on Private Foundations

As a gift or marketable securities is now "allowed" to a private foundation, the only substantive tax difference involves gifts of private company shares to private foundations.

The Philanthropic Fund

A philanthropic fund is basically a name borrowed from the Americans. What can occur in Canada is similar but is not identical to the American situation. To borrow this term in Canada, a family creating a philanthropic fund within the JCF can achieve major tax advantages, flexibility and, most importantly, significant personal satisfaction. A philanthropic fund is a gift that is accepted and managed by the Jewish Community Foundation. The fund usually bears the name of the donor or the donor's family. The basic element of such a fund is that the donor offers recommendations for distribution of the fund's income to Canadian charitable organizations.

The capital will be invested with the other assets of the Foundation and the fund's fair share of income will be allocated to it. On an annual basis the family will direct the income to its list of Canadian charitable organizations. All gifts made in such a manner will be made in the name of the family fund. It is possible that a donor may wish to invest "his/her" fund personally; in some cases this wish can be accommodated.

Advantages

The advantages of setting up a fund in this way include the following:

1. Ability to decide where the income will be used;
2. The right to make donations in the name of the family fund;
3. Removal of administrative work. The record keeping, investments, cheque writing, communication, will all be done by the JCF.
4. No income tax returns need be filed by the fund as the JCF itself as a whole files the tax return.
5. As previously discussed, the taxation of private company shares is enhanced.
6. By creating a relationship within the Federated/ Foundation system, one can take advantage of their experience in grant-making mechanisms to extend the donor's philanthropic endeavours.
7. It is possible, with other families, to make joint gifts to create more charitable opportunities.
8. One may take advantage of the staff of the Federation and Foundation.
9. A fee, usually a percentage of income earned, is charged by the Foundation. However, this fee is usually quite small compared to actual costs of running a private foundation.
10. Given the long-term nature of the relationship between Federation/Foundation and the families, the relationship with the JCF can allow for a succession of moral values to the next level of family. With children living in different cities, it is easier to deal with the JCF.
11. CRA has created substantially enhanced public disclosure rules. The capital within a private foundation and its donations (charities and amounts) are public knowledge and, with this information, a target for fundraisers. The JCF can achievea anonymity for the donor.
12. Certainly, the private foundation offers autonomy and some confidentiality. Greater confidentiality can be maintained within the JCF but it is understandable that some families will wish to maintain their own private foundation.

21 Gifting U.S Assets

Canada-U.S Charitable Transactions

This handbook is intended to act as a guide for professionals in dealing with their clients. This is even more the case for this chapter on cross-border gifting provisions between Canada and the United States. It is not intended to review all of the income tax and charitable aspects between these systems. It is solely to offer a few directions which may aid the professional to begin his/her research.

Americans Donating to Canadian Charities

An American may make a gift to a Canadian Federation or Foundation. The tax effects vary, however, with the facts and the types of assets which are being gifted.

The American will be limited to an annual limitation on contributions to 50% of adjusted gross income for cash and ordinary income property and 30% for long-term capital gain property. Contributions in excess of these annual limitations can be carried forward up to five years. However, for lifetime gifts to Canadian charities these limits will be based on the American's Canadian source income. For example, if an American has $100,000 of US source income and $20,000 of Canadian source income, he will be entitled to make a gift to a Canadian Federation/Foundation to the extent of 50% of his/her Canadian source income or $10,000. Any excess contribution could be carried forward five years to be applied again to Canadian source income in those years. This provision, allowing for Canadian donations to be applied against Canadian source income is based on the Income Tax Treaty between Canada and the United States.

Americans do have a substantial estate tax liability. In this particular situation, the status of Canadian charities is much more beneficial. A bequest to a Canadian Federation/ Foundation would qualify as a US gift, if the Canadian charity e.g. the Federation/ Foundation would have been considered a US charity if the organization had been situated in the US. This is clearly the case for our Federations and Jewish Community Foundations. A bequest to the Federation/ Foundation would be totally deductible in arriving at estate tax liabilities. This rule does not apply if one is attempting to achieve an estate tax deduction by the creation of a charitable remainder trust to the Canadian charity.

Canadian gifts of U.S sited property

It is permitted under the Income Tax Act for gifts to be made to Canadian charities of non-Canadian sited property. The normal income tax effects will occur for Canadian purposes, based on the deemed disposition rule for gifts. Depending on the type of property transferred, the disposition to the charity may be subject to US income tax.

U.S Shares

Under the Canada-US Treaty, it is doubtful that shares of US corporations gifted to a Canadian Federation or Foundation will be subject to American tax unless the shares' basis of value is real estate. The Canada-US Treaty exempts Canadians generally from taxation on disposition of American capital assets except for real estate.

US corporation shares are subject to American estate taxes on the death of a Canadian. The Canada-US tax treaty does create an exemption to reduce or eliminate this tax. However, if there is an estate tax problem and it is intended that these assets be gifted, then it seems preferable to gift them during the lifetime rather than at death as the Canada-US treaty will eliminate the US taxation on the capital gain arising from the sale of the US shares during lifetime.

Please refer to competent US professionals for tax advice in arranging any of these gifts.

U.S Real Estate Gifts

The Canadian will be subject to US capital gains tax on the gifting of US real estate to a Canadian Federation/Foundation. Of course, for Canadian purposes, the transaction is taxable as well, and of course for Canadian purposes a charitable donation receipt can be usable on the return. Given that both tax jurisdictions will be taxing the transaction, a foreign tax credit will be allowed on the Federal Canadian return for any tax paid within the United States on the transaction.

There is gift tax liability in the United States, and a gift to a Canadian charity may be subject to gift tax. There are allowable credits which can be used by Canadians to offset the tax due. If the real estate was given by bequest to the Canadian charity, there will be no capital gains tax in the United States on the gift but the donor's estate will be subject to estate tax, offset by the allowable credit. Also note that due to the US-Canada tax treaty, the estate tax paid in the United States is allowed as a foreign tax credit on the Canadian income tax return

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22 Contrasting the Federal and Quebec Taxation Acts

Since the establishment of the Canadian charitable donations system, the province of Quebec has depended on the Federal system. The certification of charitable organizations and allowing them to issue donation receipts is a Federal activity. Monitoring these organizations to ensure compliance with the law has been left to CRA. CRA has developed a substantial charities division which is less necessary for Quebec; although Quebec does have its own verification system.

The two tax systems, Federal and Quebec, basically mirror each other. The Federal government had made substantial changes to charity tax law, which had not been adapted immediately by Quebec. Happily, Quebec has harmonised and the differences between the regimes are minor and not usually significant.

Art and Cultural Property

The donation of certified cultural property yields the identical tax results for Federal and Quebec purposes. However, gifts of other art are taxed differently. For Federal purposes, a donor of art to a charity will receive a donation receipt equal in value to the art. The taxpayer is deemed to dispose of that art at its fair market value and could realize a capital gain in relation to the gift. For Quebec, the rule is similar if the charity is in the art "business" e.g. museums. For gifts to other charities where it is assumed that the art will be sold, Quebec legislates a system whereby the donation receipt received will not be equal to the value of the art. For Quebec, the receipt will be equal to the actual selling price of the art piece by the charity. The charity will have five years to make the sale. When it does sell the art, the charity receipt will be used by the taxpayer in the year in which he/she actually donated the art. The donor may have to refile his/her Quebec tax return.

What is a little upsetting from the Quebec situation is that in the year of gift one will realize and pay tax on the disposition. Presumably, the fair market value would be what the evaluation is in the year of gift and one would report a capital gain based on the disposition. The donation receipt, although usable in the year of disposition, may only save tax at a later time and the amount of the receipt can be less than the value at the date of the gift. Therefore tax may be prepaid unfairly and it is possible that the donation receipt may never be usable if the charity does not dispose of the art.

Donation of Appreciated Assets

In its 1996 budget the Federal government moved to ensure that any capital gain inclusion created as a result of a gift to a charity would result in an increased income limit for charitable purposes. In other words, if a donor in gifting appreciated property realizes a taxable capital gain the Income Tax Act will ensure that the corresponding donation receipt can be usable completely to offset the taxable capital gain by combining the limit of 75% of income with an additional 25% of the taxable capital gain realized to ensure that 100% of the taxable capital gain realized can be offset by the donation receipt.

Quebec has adopted the extra 25% change but only if the charity uses the capital property in its operation.

One of the ways around this problem is an election which is available both federally and in Quebec. This election, which is done within the donor's tax return, allows a taxpayer to elect anywhere between his/her adjusted cost base and fair market value of the donated property to determine his/her proceeds of disposition for capital gain purposes. Of course, the amount that is elected will be the amount of donation receipt which is usable for tax purposes. In this way, you can ensure that one does not pay tax today on a gift unnecessarily. In this case, if applicable, one would elect on the Quebec return only. The negative effect of this election is that you are probably giving up excess donation receipts. For Federal purposes, it seems that this election will have little use with the new enhanced limit rules. For Quebec purposes, however, the election is still valuable. The election for Quebec purposes is effected pursuant to Article 752.0.10.12 of the Quebec Tax Act.

Recaptured Depreciation

Federally, 75% of income can be offset by a donation receipt. In addition, 25% of recapture created on a donation of real estate is added to the limit to ensure that the recapture will be sheltered by the donation receipt. Again, Quebec has not adopted the extra 25% rule unless the real estate is used by the charity.

On the subject of real estate, Quebec's rule for transfer or mutation taxes is onerous for charities as the calculation is based on the greater of two amounts, the proceeds of sale (nil for a gift) and the municipal evaluation. In other provinces, the municipal evaluation is not considered and thus the transfer taxes are nil.

Quebec Taxpayers with Jurisdiction Inside Quebec and Outside Quebec

There are a number of taxpayers who can utilize the credit system to their advantage if they have establishments in Quebec and outside Quebec. Consider an individual who has a professional practice in Quebec and in Ontario. Assume half of his/her income is derived from Quebec and the balance in Ontario and, therefore, half of his/her provincial tax is paid in Quebec and half is paid in Ontario. Assume further that his/her spouse is resident in Quebec with Quebec taxable income only. A donation receipt used for Federal purposes by the professional would result in a tax saving on both his/her Federal tax and his/her tax in Ontario, which accounts for half his/her provincial tax. Thus, the effective use of the donation receipt would mean an approximate 39% saving. If he/she uses the donation receipt on his Quebec tax return also, 11% would be saved based on the fact that half of his/her provincial tax is payable in Quebec. It would be preferred in this situation to have his/her spouse utilize the donation credit for Quebec tax purposes. As the spouse pays all of his/her provincial tax in Quebec, there would be a 22% tax saving on that return.

The professional would still use the donation receipt on his/her Federal return. As a family, the professional would be saving 39% on his/her Federal return and the spouse would save 22% on his/her Quebec return which would mean that a donation receipt would actually save $0.61 on the dollar therefore making it much more amenable to make donations.

Updated **May 2010**

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