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2015-16

CANADIAN DONOR'S GUIDE

to fundraising organizations in Canada

GUIDE DES DONATEURS CANADIENS

faisant état des organismes de souscription de fonds

In partnership with

Estate & Trust Services from Scotiatrust®

Scotiabank®

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CHARITY CHECKLIST

Lauren Storer
Scotia Private Client Group

Three Tips for Estates

Naming one or more charities as part of your estate plan is often as simple as that: getting the charity name correct in the will. But there is more to planning a gift by will than being accurate about the name. Here are three tips to help you plan better estate donations.

1. Check out the charity online

All registered charities must make annual information filings to Canada Revenue Agency (CRA) – the T3010 form -- and this information is made public. If you are planning to make a significant gift in your will to one or more charities basic due diligence about the charities' finances is helpful.

The T3010 contains basic financial information such as revenue (including annual donations), expenditures (programs, administration, fundraising, grants, etc.), investments, liabilities, program descriptions, board of directors, top salaries, and even the recipients and amounts of grants to other charities. This annual filing is posted on the CRA website, which can be found by searching "CRA charities" in any search engine.

CRA provides annual reports with a single year of data, so it is difficult to see trending information for the charity. For example, are they growing or shrinking? Increasing expenses or cutting back on programs? The free online database Charity Focus provides some trending information, as well as related resources provided by the charity. The resource I most often use is CharityCAN. CharityCAN provides five-year reports and comparative data against peer organizations.

Finally, many charities have websites. The better websites contain annual reports and audited financial statements. Depending upon your own standard of due diligence, these documents can be very revealing about the culture, health and effectiveness of the charity.

2. Speak to your charities

Donors are often reluctant to speak to charities about their estate donation intentions. They worry about privacy, making an irrevocable commitment, and unwanted fundraising. In the case of significant estate donations, we recommend speaking to the charity either by phone or in person. This is especially true if your intended donation has a restricted purpose.

Ask about how bequests are used, what kind of accountability is provided to donors (i.e. annual report, donation reports), options to recognize a loved one or yourself, indicators of charitable effectiveness and privacy policy. Don't be afraid to ask a few tough questions to ensure your trust in the organization is well grounded. With large estate donations, we always say: "Trust should be earned, not assumed."

If you do not feel comfortable speaking to the charity, ask your lawyer or another advisor to assist. As part of the estate planning process at Scotiatrust this is a standard step. It is a service we provide through Aqueduct Foundation, which has personal legacy foundations.

3. Review your will due to the new estate donations rules

As of 2016, the tax treatment of gifts by will and direct designation gifts of RRSP/RRIFs, TFSAs and life insurance will change. Under the new rules the charity will issue a tax receipt for the donation based on value at date of transfer. If the transfer occurs within 36 months after death, a period known as the "graduated rate estate", the tax credit can be claimed over a period of five years, which is an increase from the current two-year window.

The five years are: 1) the taxation year of the estate in which the donation is made; 2) an earlier taxation year of the estate; and 3) the final two lifetime tax returns of the deceased against up to 100 percent of the income recorded on each of those tax returns. Previously, the donation was valued at date of death, and there was no 36-month deadline to transfer the property.

The good news is that estate donations that are large relative to income will, in many cases, be eligible for more tax savings. There are, however, some concerns. Novice executors may miss the distribution deadline and lose tax benefits. Estates with illiquid property, such as private company shares or real estate, may find the 36-month deadline to be challenging. There is also risk due to delays caused by litigation.

At Aqueduct Foundation, we use personal foundations to manage estate donations. Aqueduct can reduce the loss of tax benefits with large and complex estate donations by accepting property in kind, rather than waiting for cash. The goal is to ensure your charities receive the intended gift and for your estate to receive the maximum tax savings.

Lauren Storer
Manager, Philanthropic Advisory Services
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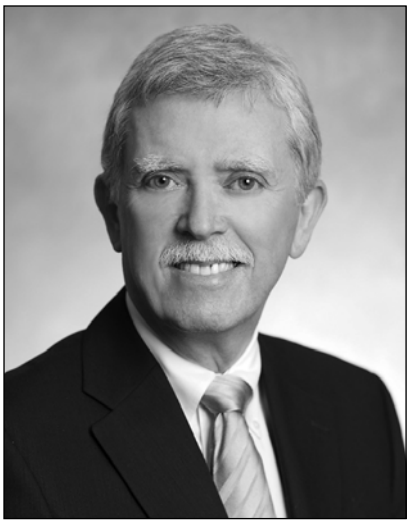
www.aqueductfoundation.ca

CHARITABLE DONATIONS

A Summary of Tax Considerations



James M. Parks
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OVERVIEW

Tax consequences are an important factor in structuring charitable gifts. Proper planning can increase the benefits to the donor, which are often a major incentive for charitable giving. A gift to a registered charity by an individual (including a trust) entitles the donor to a deduction in computing tax otherwise payable, whereas a gift by a corporation entitles it to a deduction in computing taxable income, as opposed to a tax credit. These rules are found in section 118.1 of the Income Tax Act (the "ITA") for gifts by individuals and section 110.1 of the ITA for gifts by corporations.

2015 BUDGET PROPOSALS

The April 21, 2015 federal budget proposes several changes dealing with charitable donations as follows:

1. For dispositions after 2016, where a taxpayer disposes of real estate or shares of a private company, any realized capital gain will not be taxable, to the extent that "cash proceeds" from the sale are donated to a qualified donee within 30 days after the disposition and the disposition was made to a person dealing at arm's length with both the taxpayer and the qualified donee. The exempt portion of the capital gain will be based on the portion of the sale proceeds donated compared to the total proceeds.
2. Under current law, a charity is regarded as carrying on a business if it is a member of a partnership. Private foundations cannot carry on any business and charitable organizations and public foundations can only carry on a "related" business. A registered charity will not be considered to be carrying on a business solely because it acquires or holds an interest in a limited partnership, if the charity and non-arm's length entities together hold no more than 20% of the interests in that partnership and the charity deals at arm's length with each general partner of the partnership. Similar changes will be made for other qualified donees including registered Canadian amateur athletic associations ("RCAAAs"). The "excess business holdings" rules will continue to apply to investments in corporations through limited partnerships by private foundations. The rules dealing with "non-qualifying securities" and the "loan back" rules, will also apply to interests in limited partnerships. These rules will be effective for investments in limited partnerships made or acquired on or after April 21, 2015.
3. The rules that permit CRA to treat certain foreign organizations as qualified donees will be extended to all foreign charities. This will enable foreign organizations that are not necessarily "charitable organizations" for purposes of the ITA to apply to be treated as qualified donees.

BASIC TAX RULES

Individuals

An individual donor can claim a credit against tax otherwise payable. This summary comments on charities that are registered by Canada Revenue Agency ("CRA"), RCAAAs, certain non-profit housing corporations, Canadian municipalities, the crown, the United Nations and certain foreign charities (including certain foreign universities) and other donees. Credits or deductions are available only for gifts to "qualified donees", except as noted. The federal tax credit is calculated at the lowest personal tax rate of up to $200. For gifts exceeding $200, the credit is 29% of the amount of the gift. A comparable tax credit is available in calculating provincial taxes, with special rules in Quebec. An individual can claim credit for gifts of up to 75% of net income for the year. Unused credits can be carried forward for five years and used to offset tax in those years, subject to the 75% limit. The limit does not apply in the year of death or the previous year. The 75% limit is increased by 25% of taxable capital gains realized making a gift of appreciated capital property, and 25% of recaptured capital cost allowance on a gift of depreciable property (to a maximum of 25% of the lesser of the capital cost or the fair market value of the property).

Corporations

A corporate donor can claim a deduction in computing taxable income, and is subject to the 75% limit noted above for individuals. It can claim a deduction of up to 75% of its net income for the year plus 25% of a taxable capital gain and 25% of recaptured capital cost allowance on a gift of depreciable property (to the same maximum mentioned above.

TYPES OF GIFTS

The following are some basic features and tax consequences of certain types of gifts.

1. Gifts by Will

Gifts can be made by will, as "testamentary" gifts. The donor ("testator") states in a will that on death, property is to be given as a bequest or legacy to a named charity or a charity to be chosen by the executors. The gift can be cash or property, such as a work of art or shares. If the testator leaves too much discretion to the executors in choosing a charity or the amount of the gift, CRA could allege the gift is made by the estate and not deemed to be made in the year of death.

Under the 2014 federal budget changes, gifts made by will for deaths after 2015 are deemed to be made by the estate rather than by the deceased in the year of death. The estate can elect to claim the credit in the year of death or the preceding year. The transfer of property must be completed within 36 months after death. For deaths before 2016, the testator is deemed to have made the gift immediately before death and a tax credit is available in the terminal return. Unused credits can be carried back and used to reduce tax in the prior year. The credit can offset 100% of net income for the year of death and the prior year. This credit can be useful in calculating tax in the year of death, since the deceased is deemed to have disposed of capital assets immediately before death (subject to certain exceptions, such as for spousal rollovers) at fair market value, realizing capital gains in that year.

The 2014 changes also affect the rules for gifts made by will or by direct designation in RRSPs, RRIFs, TFSAs and life insurance policies.

2. Annuities

Charitable organizations can issue annuities, but charitable foundations can be deregistered if they incur ineligible debt obligations. A charity should ensure that it has legal authority to issue annuities under provincial law dealing with insurance or other relevant laws. The charity can purchase an annuity from a financial institution rather than issuing it itself, to reduce its risk of loss. The value of property received from a charity in exchange for a gift must be determined and becomes the cost of the property to the charity. Where an amount is transferred to a charity and the donor receives a stream of annuity payments, the amount of the gift will be equal to the excess of the amount transferred by the donor over the amount that would be required to purchase an annuity providing the same payments.

3. Life Insurance

A charity can benefit from gifts of life insurance policies in several ways. A gift of an insurance policy can result in a large donation, at a relatively small cost to the donor. A charity can purchase an insurance policy on the donor's life on the understanding that the donor (or some other person) will pay the premiums directly to the insurance company. This is often supported by a pledge to pay the premiums. The charity can issue a tax receipt for the premiums paid. On the death of the donor, the charity will receive the death benefit, which will not be a gift by the donor. A drawback from the charity's point of view is that there may be no assurance the donor will pay the premiums. If the donor fails to pay, the charity can surrender the policy or pay the premiums using its own funds.

Alternatively, the donor can transfer an existing policy to the charity and agree to pay future premiums. The charity can issue a receipt for the fair market value of the policy, which may be the cash surrender value (normally only whole life or universal life policies will have a value) less any outstanding policy loans. The charity can issue a tax receipt for premiums paid. The donor may have to report income based on the fair market value of the policy, which is based on all of the relevant factors. If a qualified valuator determines that the fair market value of the policy exceeds its cash surrender value (less any outstanding policy loans), the higher amount should be the eligible amount in the receipt issued by the charity. The donor will be subject to tax on the amount by which the cash surrender value (less any outstanding policy loans) exceeds the adjusted cost basis (a defined term) of the policy. CRA has stated that this is not affected by the issuance of an official receipt by the charity reflecting a fair market value that is higher than the cash surrender value.

If the charity is concerned that it will not be able to pay the premiums, the donor (or another donor) can give cash, which the charity can use to buy an annuity providing periodic payments to fund the premiums. The charity should be able to treat the annuity and policy in a way that does not cause problems in meeting its disbursement quota. Alternatively, the charity could rely on a promise from the donor (or another donor) to make annual gifts to pay the premiums. The ability to pay the premiums on a donated policy could be a factor in determining the fair market value of the policy. If the policy is likely to lapse because the charity does not pay the premiums, the fair market value could be reduced. A registered charity is not required to pay tax on its income and should not be adversely affected if a policy is not "exempt". The eligible amount of a gift of a life insurance policy will be the lesser of its fair market value and the "cost" of the policy to the donor, if the gift is made within three years after the donor acquired it.

The donor can continue to own the policy, and name the charity as the beneficiary. The donor will receive no tax relief for the premiums paid or the value of the policy, since no property is being given to the charity. Under insurance law, the donor can change the beneficiary from the charity to another person. If the charity is the named beneficiary, it will receive the death benefit on the donor's death. The donor is deemed to have made a gift to the charity immediately before death, if the charity receives the death benefit under the policy within 36 months after death. The fair market value of the gift is deemed to be the fair market value, at the time of the individual's death, of the right to that transfer. The Department of Finance has stated that "in nearly all cases" the fair market value at death of the right to transfer is "expected to be" the fair market value at death of the money that is ultimately received. A donor can use life insurance proceeds to pay a bequest in a will, naming the estate as beneficiary. On the donor's death, the estate would receive the death benefit free of tax and pay the bequest to the charity, which would issue a receipt. The credit could reduce tax in the year of death or the prior year, if there are excess credits. In some provinces, probate tax on the value of the proceeds passing through the estate may be a factor. The 2014 changes will affect how these gifts will be treated. Where life insurance proceeds are paid to an estate and used to pay a bequest, the gift will be treated as a gift by the estate, subject to an election to carry it back to the year of death.

Other arrangements may be tax-effective, such as having a private corporation purchase insurance on the life of one of the shareholders. There are techniques to take advantage of the tax-free proceeds on death, the capital dividend account of the corporation, the rules for taxation of dividends and "post-mortem" planning. Subject to a spousal rollover, capital gains are realized in the year of death. In some cases there can be "double tax" because the deceased owns shares of a corporation that owns assets with unrealized gains. Life insurance can often be used to reduce those gains or the tax, in combination with charitable donations.

In some situations, the features of the policy are shared or ownership of the policy is split. This type of planning raises a number of regulatory and tax issues and requires sophisticated advice for both the donor and the charity. Recent changes prevent arrangements designed to deduct interest on money borrowed by private corporations to buy life insurance policies and use the capital dividend account when the death benefit is paid. It also changed the treatment of some back-to-back arrangements and prescribed life annuities.

4. *Gifts of Residual Interests*

A donor can give property to a charity, while retaining the right to use it for his or her lifetime. Alternatively, the donor can establish a charitable remainder trust by transferring assets to the trust, reserving a right to receive payments for life and transferring the balance in the trust on death to a charity. If certain conditions are met, CRA considers the donor has made a current gift. This type of gift could be made during a person's lifetime or by will. The 2014 changes affect testamentary gifts of the residual interest in an estate. The value of the gift will be the fair market value of the transferred property (usually cash) less the present value of the reserved interest, taking into account an appropriate discount rate, the life expectancy of the donor, current interest rates and any other relevant factors. This type of gift is analogous to a charitable annuity. If there is a right to encroach on the capital, the value of the residual interest is considered to be nil. A trust will generally be required for gifts of property other than real estate.

CRA has stated that the gift of a beneficial interest in the capital of a charitable remainder trust is not automatically treated as a gift of a non-qualifying security, but the general anti-avoidance rule might apply if the trust owns non-qualifying securities. CRA will consider whether the trust is "affiliated" with the donor immediately after the gift was made. If the donor retains a beneficial interest in the income of the trust, the donor may be "affiliated" with the trust. Whether this is the case will be a question of fact. A trust and a person are affiliated if the person is a "majority-interest beneficiary". This includes a person who has a beneficial interest in the income of the trust if it has a fair market value that is greater than 50% of the fair market value of all beneficial interests and a person who, with an affiliated person, holds beneficial interests in the income of the trust if the fair market value of those interests is greater than 50% of the fair market value of all beneficial interests.

Using a charitable remainder trust or making a gift of a residual interest by will often involves reliance on administrative policies of CRA and raises a number of technical issues. The Department of Finance had considered changes in the ITA dealing with charitable remainder trusts, but no amendments have been introduced. Specific advice should be sought before this type of planning is utilized.

5. *Gifts of Capital Property*

A donor of capital property is deemed to have received proceeds of disposition equal to the fair market value of the property. If the fair market value exceeds the cost, a capital gain will be realized. If the property is depreciable property, recaptured capital cost allowance is included in income. A donor can reduce capital gains tax on a gift of appreciated capital property to a charity by designating the transfer price as an amount not greater than its fair market value and not less than its adjusted cost base. The donor will then be deemed to have disposed of the property for the designated amount and considered to have made a gift of the designated amount when calculating the tax credit or deduction. This enables the donor to avoid realizing a capital gain altogether, or realize only a desired amount of capital gain (for example to offset capital losses). There are restrictions for non-resident individuals disposing of Canadian real estate to a charity.

The amount to be included as a taxable capital gain is nil for gifts of securities traded on a designated stock exchange (such as shares, bonds, warrants and debentures) and mutual fund shares or units or shares or interests in certain segregated funds. It is more tax-efficient for the donor to give securities directly to a charity, rather than sell them and give the proceeds to it.

An employee who exercises a stock option is taxed on a benefit equal to the difference between the fair market value of the shares at the time of exercise and the sum of the exercise price plus the amount paid for the option. In certain circumstances, the employee can claim a deduction against the stock option benefit so only 50% of the benefit is taxable. If an employee stock option is exercised and marketable securities are given to a qualified donee in the year and within 30 days after the option is exercised and if certain other conditions are met, only one-quarter of the benefit is taxable. Individuals who make qualifying donations of marketable securities acquired through such stock options are not required to report any of the benefit.

Taxpayers who own eligible unlisted exchangeable securities can exchange them without causing tax to be payable on a gain. There is no tax on a gain on the exchange, and the donor can receive a receipt for the donation of the listed securities received on the exchange, without recognizing a gain. This beneficial treatment for capital gains on gifts of marketable securities applies to capital gains on the exchange (with some exceptions) of unlisted securities for listed securities where:

(a) at the time they were issued, the unlisted securities included a condition allowing the holder to exchange them for the listed securities;

(b) the listed securities are the only consideration received on the exchange; and

(c) the listed securities are donated within 30 days after the exchange.

There are special rules for exchangeable partnership interests. These are intended to ensure that gains attributable to a reduction in the adjusted cost base of the partnership interest are not exempt.

A gift of a "non-qualifying security" to a charity will be ignored in determining the tax deduction or credit in most cases. A non-qualifying security generally includes an obligation of the donor or a non-arm's length person, a share issued by a corporation with which the donor does not deal at arm's length or any other security issued by the individual or a non-arm's length person. There are exceptions for obligations, shares or securities listed on designated stock exchanges and deposits with financial institutions. If the property is disposed of within five years of receipt of the gift, or ceases to be a "non-qualifying security" within the five year period, the person will be treated as having made a gift at that time. This rule does not apply to an "excepted gift", which is generally a gift to an arm's length qualified donee that is not a private foundation, if the donor deals at arm's length with all of the donee's directors or trustees immediately after the gift. The objective of these rules is to deny a tax credit for certain types of gifts, including shares of privately held companies, subject to some relief if the donee disposes of the security within five years. The rules apply where the non-qualifying security is donated to a trust of

which the registered charity is a beneficiary.

Rules dealing with "loan-back" arrangements apply where a person donates property to a charity which is not dealing at arm's length with the person and receives a loan from the charity, or is allowed to use the property donated to the charity. The fair market value of the gift is reduced for purposes of calculating the tax credit. These rules apply to certain arm's length arrangements. CRA's administrative positions on gifts of capital property are set out on its website.

Recognition of a gift is deferred until the time (within five years after the donation) when the qualified donee has disposed of the non-qualifying security for consideration that is not, to any person, another non-qualifying security. An anti-avoidance rule provides that, if as a result of a series of transactions, a particular person holds a non-qualifying security of a donor and the donee has acquired a non-qualifying security of that person or of the donor, the gift will be deferred until such time (within five years of the donation) as the donee disposes of the non-qualifying security for consideration that is not another non-qualifying security of any person.

The courts have treated payments involving leveraged loans as investments rather than gifts, where a significant benefit flowed to the taxpayer. The CRA website contains information about potential problems for donors dealing with tax shelters and other arrangements that depend on official receipts issued for more than a cash payment made with no strings attached. CRA has said it will challenge arrangements that seem to be "too good to be true", particularly where the donor does not just pay cash or transfer property, but is involved in a more complex arrangement with a charity, a promoter or others.

CRA has stated that where an individual owns "thin" controlling voting shares of a private corporation, under which she is not entitled to receive dividends or to participate beyond a nominal amount on winding up, but controls the corporation, in some circumstances it will treat the shares as having more than a nominal value. A gift of those shares to a registered charity could offer flexibility in dealing with the valuation issue, particularly if an election is made to treat the amount of the gift as the adjusted cost base of the shares. However, this could raise other issues, including problems under the excess business holdings rules for private foundations and "acquisition of control" issues for charitable foundations.

Unlike the rules which permit a donor to avoid recognition of a capital gain when donating marketable securities, the 2015 budget proposals will require the donor to dispose of shares of a private company or real estate and then donate the "cash proceeds". This is intended to insure that the charity is not required to "monetize" the value of property. For marketable securities, it is generally fairly easy way for the charity to dispose of the securities for cash. This is not the case with shares of private companies or real estate. The proposals will avoid valuation issues. The charity will receive cash and issue an official receipt for the eligible amount of the gift. Valuation will be the responsibility of the donor, who will be required to dispose of the property in an arm's length transaction, subject to anti-avoidance rules.

In some cases, real estate will consist of land and depreciable property, such as a building. There will likely be recaptured capital cost allowance in many cases, requiring the donor to include in income the amount previously claimed on cumulative basis, to shelter income in previous years. The proposals dealing with interests in limited partnership should be helpful for charitable organizations and public foundations that can carry on a related a business. They will be less helpful for private foundations, which cannot carry on any business and are subject to the excess business holdings rules.

6. *Gifts of Art, Cultural and Ecological Property*

(i) Art

Certain gifts of inventory by an artist receive special treatment. In those circumstances, where an appropriate designation is made, an artist is entitled to a credit based on the fair market value of the property but no income is triggered on the disposition.

Artwork is generally considered to be personal-use property unless it is inventory. Personal-use property is property that is used primarily for the personal use or enjoyment and includes jewellery, clothing, furniture, and certain works of art. For purposes of calculating the capital gain or loss, the adjusted cost base and proceeds of disposition of personal-use property are deemed to be at least $1,000. This rule eases the compliance and administrative burden associated with the reporting of dispositions of personal-use property. The $1,000 deemed adjusted cost base and deemed proceeds of disposition for personal-use property will not apply if the property is acquired after February 27, 2000, as part of an arrangement in which the property is given to a charity. Therefore, where this type of property with a value of less than $1,000 is donated to a charity in those circumstances, it will no longer be treated as personal-use property, and any resulting capital gain will be taxable.

(ii) Cultural Property

A gift of certified cultural property to a designated institution will not trigger a capital gain. The donor will be allowed a credit (if an individual) or a deduction (if a corporation) for the fair market value of the property and will not be limited to 75% of income. There are special rules for determining the fair market value of cultural property. In addition, any capital gain on an object that is donated is exempt from tax. The determination is made by the Canadian Cultural Property Export Review Board and there are extensive rules for the procedures to be followed and appeals if the amount determined is not acceptable to the donor. The Board must certify the property and designate the institution. Any unused credits or deductions can be carried forward for five years, or back one year in the event of death. Charities receiving gifts of cultural property are subject to a penalty tax in certain circumstances if they dispose of the gifted property within ten years of its receipt. If the gift is part of a "tax shelter gifting arrangement", the donor cannot use a value for the property in excess of the cost amount.

(iii) Ecological Property

There are similar rules for gifts of ecologically sensitive property to the crown, a municipality or a charity that is approved for the conservation and protection of the environment. There are incentives for owners of ecologically sensitive land to protect that land while at the same time qualifying for a tax benefit. The precise nature of the conveyance of property will depend on legal issues and in some cases there may be split ownership.

There are special rules for valuing gifts of ecological property. These include gifts of the land itself and gifts of easements over the land. The use of easements provides some flexibility, permitting the owner to retain legal title while fettering its future use and preventing development, but this can raise difficult valuation issues in some cases. The fair market value will be determined by the Minister of the Environment and there are extensive

rules for the procedures to be followed and appeals if the amount determined is not acceptable to the donor. As in the case of gifts of cultural property, a charity accepting a gift is subject to a penalty if it disposes of the property within ten years or changes its use without the consent of the Minister of the Environment. Under the Ecological Gifts Program, Environment Canada certifies that land is ecologically sensitive and an expert panel certifies the value.

Deductions or credits for gifts of ecologically sensitive land or interests in that land are available for carry-forward for 10 years, rather than the usual five years.

7. *Gifts of Inventory*

Unlike gifts of capital property, gifts of inventory do not permit the donor to choose an amount between the cost of the property and its fair market value. As a result, a gift of property that is part of the inventory of a business will result in an income inclusion. While there will be a corresponding eligible amount for the gift (the eligible amount will depend on whether any advantage is received by the donor), it is frequently less advantageous to donate inventory rather than capital property. This is one of the reasons why special rules were enacted for gifts of inventory made by artists, as discussed above.

Corporations can claim a deduction for gifts of medicine held in inventory to a registered charity, if the charity has received financial assistance from CIDA and uses the medicine in carrying out its foreign activities. For gifts made on or after July 1, 2008, the medicine must have been available to be used by the charity at least six months prior to its expiration date and must qualify as a drug (within the meaning of the Food and Drugs Act) which meets certain technical requirements. In addition, a prescribed return must be filed and the charity must in the opinion of the Minister of International Cooperation meet certain conditions prescribed by regulation. This limits the situations in which corporations can claim tax relief for donations of medicine from inventory.

8. *Gifts to the Crown*

A gift to Her Majesty in right of Canada or Her Majesty in right of a Province (a "crown gift") is subject to the same income limitation as other gifts, i.e. 75% of the donor's income for the year plus 25% of any taxable capital gain, plus an amount equal to 25% of recapture of previously claimed capital cost allowance. Consequently, crown gifts provide the same tax relief as gifts to other qualified donees. The crown will include an agent of the crown, and gifts to the museums listed in the Museums Act (including, for instance, the National Gallery of Canada, the Canadian Museum of Civilization, the Canadian Museum for Human Rights and the Canadian Museum of Nature) are treated as gifts to the crown.

9. *Charitable Donations of RRSPs, RRIFs and TFSAs*

Donations made as a consequence of a direct designation of proceeds of RRSPs, RRIFs or TFSAs to a charity on the death of an individual qualify as gifts eligible for the individual donation tax credit, if the transfer of funds from RRSPs or RRIFs to the charity occurs within 36 months of death. The fair market value of the gift is deemed to be the fair market value, at the time of the individual's death, of the right to the transfer. Since the balance in an RRSP or RRSP is treated as income in the year of death, in the absence of a rollover to a spouse, the credit for a gift to charity in the year of death will effectively eliminate the tax otherwise payable on the balance, if there is a direct designation and an election to carrying it back. This is the same result as if there were a bequest by will of the amount included in income under the RRSP or RRIF, without having to determine the amount in advance. A direct designation of a charity will be treated as a donation.

Under the 2014 changes, gifts by will and by direct designation in RRSPs, RRIFs and TFSAs and in insurance policies are affected. The gift will be treated as a gift made by the estate, which provides more flexibility. If the deduction or credit is more than can be used in the year of death or the year prior to death, the estate can carry the balance forward under the usual rules. The 2014 changes introduced the concept of a graduated rate estate ("GRE"). Gifts made by will and by direct designation of insurance policies, RRSPs, RRIFs and TFSAs are deemed to have been made when the property is actually transferred by the GRE to the charity and the estate can choose to carry back all or part of that donation. Several problems have been identified. The estate may not be able to complete the transfer within 36 months as a result of delays beyond its control, such as litigation. It is unclear how the rules will apply where there are intervening life interests created by will or in the case of charitable remainder trusts. There are technical concerns that the new rules may limit the ability of the estate to avoid recognition of gains on gifts of ecologically sensitive property, cultural property and publicly traded securities. These and other concerns are discussed below.

10. *Miscellaneous Issues*

(i) Social Media

Social media have become relevant in some donation arrangements. Some charities raise small amounts by way of text messages. Where donors are not concerned about receipts, this can be an effective way to raise money in small amounts from a wide range of donors. Similarly, "crowdfunding" techniques might be useful for some charities. If a charity engages in a concerted effort to raise money through crowdfunding, it might be regarded as carrying on a business. A charity that carries on business is subject to revocation of registration unless (in the case of a charitable organization or public foundation), the business is "related" to its charitable purposes. One registered charity facilitates the receipt of donations by way of text messages and other electronic means. Another organization enables charities to use crowdfunding and provides access to a broad range of donors, on the theory that they will give small amounts. The donors receive an official receipt, which may be important to the donor. These arrangements do not seem to cross the line and cause the charity to be carrying on a business, but simply constitute another form of fundraising.

(ii) Dividends After Death

When an individual dies, the executors can file a separate tax return reporting any "rights or things" owned by the deceased that have been transferred to a beneficiary, such as a dividend declared by a corporation but not received at the date of death. When an election is made, the amount received is income of the beneficiary. This often occurs where shares are transferred by will and the recipient is "beneficially interested" in the estate. If a corporation has declared but not paid a dividend prior to the death and the shares are transferred to a charity under the will, the dividend will not be subject to tax when received by the charity. If a dividend is declared and received by the estate after death, that dividend could be taxed in the estate, even if the shares are transferred to the charity. If the shares are transferred to the charity and the dividend is declared and paid

after the transfer, the dividend will not be subject to tax in the hands of the charity. A number of factors are often relevant in dealing with private corporation shares, death and charitable donations.

(iii) Canada/U.S. Issues

Under the Canada-United States Income Tax Convention (the "Treaty"), Canadian residents are entitled to relief for gifts made to eligible U.S. organizations, subject to 75% of income for the year from U.S. sources. There are rules without that limit for gifts made to a university or college at which the donor or a family member was a student.

The U.S. organization is not a "qualified donee", as defined in the ITA. CRA has taken the position that a Canadian registered charity cannot treat such a gift as a gift to a qualified donee. Registered charities cannot make gifts other than in the course of carrying out their charitable activities to anyone other than a qualified donee. This is often a factor in the plans for donors who wish to assist Canadian charities in carrying on activities in other countries. There is more latitude for the donor to make a gift directly to the U.S. organization than to make a gift to a registered Canadian charity, with a view to having it support the U.S. organization with a grant.

(iv) Split Receipting

Under the "split receipting" rules, the value of a gift is the excess of the value of the donated property over the value of any benefit or advantage received by the donor or a person not dealing at arm's length with the donor. This will apply where some consideration is received from the charity, such as recognition, a small gift, membership, a meal, etc. A charity must place a value on any benefit received by the donor in exchange for the payment, and issue a receipt for the "eligible" amount, even if the benefit is not from the charity itself.

(v) Tax Shelters

As a result of perceived abuses, the value of the property donated to a charity cannot exceed its cost, if a gift occurs within three years of acquisition of the property by the donor, or if the donor acquired the property within the preceding ten years and it is reasonable to conclude that one of the main reasons for acquiring it was to make a gift to a qualified donee, regardless of the actual value of the property. If property is acquired with any expectation that it may be given to a registered charity during the lifetime of the owner, its value cannot exceed its cost. This does not apply to gifts of inventory, marketable securities, Canadian real estate, certified cultural property or approved ecological property or to gifts on death, but applies to gifts of cultural property after February 10, 2014 if the donor acquired the property as part of a "tax shelter gifting arrangement". The intention of the donor when the donated property is acquired is relevant. If one of the main reasons for acquiring the property was to make a gift (other than by will), the donor may have to use the acquisition cost as the fair market value at the time of the gift. For gifts that are subject to the three-year rule or the 10-year rule there are extensive "tracing" rules to deal with transfers of property prior to the time of the gift.

The reassessment period for participants in tax shelters or "reportable transactions" is extended until three years after filing where the information that should have been filed by the tax shelter promoter or with respect to the reportable transaction has not been filed on a timely basis or has not been filed at all. In most situations, if a taxpayer files a notice of objection to an assessment, there is no requirement to pay the amount in dispute. To discourage taxpayers from participating in charitable donation tax shelters and to reduce the risk that unpaid amounts will not be collected after objections and appeals have been exhausted, CRA can collect 50% of the disputed amount of tax, interest or penalties even if an objection or appeal is pending.

(vi) Anti-Avoidance Rules

An anti-avoidance rule can apply to a charity that receives cash from a donor and uses it to buy property from the donor at more than its cost. These rules are very far reaching and can have a significant effect on a number of situations in which donors expect to receive credit for the value of the property rather than its cost. CRA expects charities to be diligent in establishing the fair market value based on the "cost" approach, and in determining the value of any advantage that would reduce the eligible amount of a gift. If a donor fails to inform the registered charity of circumstances that reduce the eligible amount, despite the amount shown on the official receipts, the eligible amount will be nil. This is a significant risk for a donor who is prepared to gamble that an advantage will not reduce the eligible amount of the gift. Registered charities should review the circumstances in which gifts of property are received when determining the eligible amount of the gift. In many cases, this will require consultations with the donor.

(vii) Intermediate Sanctions

CRA can assess charities for intermediate sanctions, which give it the option of assessing tax or penalties rather than revoking registration, for various types of non-compliance, such as issuing improper receipts, carrying on an unrelated business (in the case of a charitable foundation or charitable organization) or carrying on any business (in the case of a private foundation), acquiring control of a corporation, conferring an undue benefit and other defaults. The rules for creating endowments, transfers between charities and meeting the disbursement quota require charities to plan carefully. Anti-avoidance rules prevent "trafficking" in unused charitable donations made by corporations.

(viii) Private Foundations

A private foundation that owns more than 2% of any class of shares of a corporation is required to report its holdings together with those of persons not dealing at arm's length with the foundation when filing its T3010 return. Where the foundation holds more than 2% and the combined holdings of the foundation and non-arm's length persons exceed 20%, either the foundation or the other persons (or the group collectively) must divest to below 20%. If the divestiture does not occur within stipulated periods of time, the foundation will be subject to penalties. CRA can treat non-arm's length persons as dealing at arm's length, if sufficient reasons are given.

(ix) Disbursement Quota

The disbursement quota requires a registered charity to spend at least 3.5% of the average value of its accumulated investment assets in the preceding two years on its own charitable activities or by making gifts to qualified donees. Charitable organizations with less than $100,000 of such assets and charitable foundations with less than $25,000 of such assets are not subject to this requirement. Previous gifts with restrictions that prevent the charity from spending the capital will be restricted under charity or trust law, after the disbursement quota rules were relaxed.

(x) Refund of Gifts

CRA can issue a reassessment to disallow a credit or deduction and make consequential assessments if donated property is returned to the donor by the qualified donee. The qualified donee returning a gift must issue a revised receipt and send a copy to CRA if the amount changes by more than $50. Qualified donees must file an information return to disclose returned gifts.

(xi) List of Qualified Donees

CRA maintains a publicly available list of qualified donees, including registered charities, RCAAAs, Canadian municipalities, certain municipal and public bodies performing a function of government in Canada, certain housing corporations, prescribed foreign universities and certain foreign "organizations" (this will be extended to foreign "charities" under the 2015 budget). Most qualified donees are subject to some of the compliance rules that previously applied to registered charities and are required to maintain and make available proper books and records and issue proper receipts. Failure to do so could lead to suspension of receipting privileges, removal from the list of qualified donees or revocation of registration, in the case of RCAAAs. RCAAAs are required to have the promotion of amateur athletics in Canada as their exclusive purpose and function and are subject to rules dealing with the conferral of undue benefits and carrying on an unrelated business, similar to the rules that apply to registered charities.

CRA can refuse to register or revoke the registration of a charity or RCAAA or suspend its receipting privileges if a director or equivalent official is found to have been involved in certain inappropriate conduct. This generally would be the case if that person has been found guilty of a criminal offence in Canada (or outside Canada, if that offence, committed in Canada, would be a criminal offence) relating to financial dishonesty and has not received a pardon. It also applies to directors or equivalent officials who had been involved in the operation of a charity or RCAAA that was engaged in serious non-compliance for which its registration was revoked within the past five years, or who were "promoters" of a "gifting arrangement" or other tax shelter in which a registered charity or RCAAA participated, if the registration of the charity or RCAAA was revoked within the past five years. There is no requirement to disclose the existence of ineligible individuals in an annual return and CRA will use an educational process if it finds ineligible individuals are acting as trustees or directors, and ask the registered charity or RCAAA to remove them. This could raise non-tax issues.

(xii) Graduated Rate Estates

There will be a deemed disposition of capital property in the year of death at fair market value unless there is a spousal rollover. For deaths prior to 2016, a gift to a charity made by can offset the tax in the terminal return. Under the 2014 federal budget changes, the offsetting credit will not be available until the estate actually transfers the property to a charity (within 36 months after death) and carries the credit back to the year of death. The terminal return may have been filed, and there may be an interest cost in paying tax on the capital gain and not being able to offset it until the transfer occurs, the receipt is received and the deduction can be carried back. The 36-month limit could be a problem if there are disputes involving an estate and the transfer of property cannot be completed. There may be questions about the legitimacy of a will, the entitlement of particular beneficiaries, including the charity, etc., that create uncertainty as to whether a transfer of property can be made to the charity within that period. Under the former rules, the gift is to be deemed to have been made in the year of death, regardless of when the actual transfer takes place.

CRA says the value used as the eligible amount for a gift made by will is the same as the value used to determine the capital gain at death, regardless of the value when the property is actually transferred to the charity. Under the 2014 changes, the capital gain will apparently still be measured by the fair market value at the date of death, but the charitable receipt will be based on the value of the property when the transfer occurs, up to 36 months later. If the value of the property fluctuates (which is almost always likely to be the case, except for property with a clearly fixed value), the value of the gift will be more or less than the value used to determine the capital gain. This presents a potential mismatch, along with the concern about the interest cost, if the transfer does not occur until after the terminal return has been filed.

There are issues about transfers of the residue of an estate with an intervening life interest. Jurisprudence has established that a gift of the residue of an estate to a charity is treated as a current gift, regardless of the fact that the charity does not receive the property until later, as long as the value of the residual interest can be calculated using actuarial principles, and there is no discretion to encroach on capital prior to the death of the income beneficiary. The value of the residual interest is determined by subtracting the current value of the life interest, based on various assumptions, from the value of the assets, as in the case of a charitable remainder trust. CRA has accepted this approach.

If there is a delay in completing the transfer of property by will, there are questions about income received on that property before the transfer. CRA says the estate cannot allocate the income to the charity and deduct it in computing its income and, also treat it as a charitable donation. The estate will be able to choose one course or the other, but not both. If income earned on property not transferred until after death might be regarded as income of the estate, "payable" to the charity, deductible in computing the estate's income and included in the income of the charity, then this should be relatively neutral and not cause tax consequences for the estate or the charity. On the other hand, if the income is treated as part of the gift to the charity, there might be a delay if the property has not been transferred and the time frame for recognizing the donation is delayed. For deaths before 2016, the gift is treated as a gift in the year of death and the income from that property would likely be regarded as either income payable to the charity (and deductible by the estate) or part of the gift and thus included in the amount of the receipt for the year of death.

An estate can carry back a capital loss realized in its first year, and deduct it from realized gains in the terminal return. It is not clear if a similar mechanism will apply to enable an estate to carry back credits from the estate in the 36 months to the year of death or the year prior to death. It appears the estate will file an amended terminal return or an amended return for the prior year, if a credit is carried back. This could affect the interest that is refunded as a result of the overpayment in the terminal return or the year prior to death.

ANTI-TERRORISM RULES

Very broad rules in the ITA and other legislation give sweeping powers to the federal government to try to address abuses through which terrorism is funded through Canadian registered charities. Donors should be aware of these rules and carry out appropriate due diligence before making donations to organizations that may be subject to these rules.

Similarly, charities should carefully consider the identity of donors, and the way in which donors have obtained funds and other donated property. Charities should review their lists of donors for organizations that may be identified as terrorist groups or affiliated with such groups or that might (even unknowingly) be assisting that type of activity. This can be of particular concern for organizations that are members of affiliated groups of charities, since one organization can be exposed for activities of another in certain circumstances. Both charities and donors would be well advised to consider these issues if there is any possibility of a terrorist connection. CRA has issued a checklist to help charities and donors identify potential problems and assist charities in developing good management practices. In addition to the ITA, the Charities Registration (Security Information) Act ("CRSIA") may be relevant. Under the CRSIA and the ITA, registration can be revoked if a charity makes its resources available, directly or indirectly, to a "listed entity" for purpose of the Criminal Code or an entity that engages in "terrorist activities" or activities that "support" terrorist activities. There are other prohibitions on funding or otherwise facilitating terrorism. Current proposals will make terrorism a more relevant issue for many charities, particularly if they carry out foreign activities. More information can be obtained from the CRA website.

The annual T3010 return must disclose information about funding, and in particular, information about funding from non-resident donors. If a registered charity or RCAAA accepts a donation from another country or an agency of that country that Canada considers to be a supporter of terrorism for purposes of the State Immunity Act, the Minister of National Revenue can refuse to register it or revoke its registration. The federal government is proposing stringent new rules relating to anti-terrorism, including rules that could apply to charities and other qualified donees.

2015 BUDGET ISSUES

The Notice of Ways and Means Motion dealing with the budget does not provide details about the proposals for donations of cash proceeds of sales of private company shares or real estate. It is not clear if a tracing mechanism will be required so the actual sale proceeds are donated or if an "amount" of cash, based on the sale proceeds, can be donated. The Department of Finance may adopt rules similar to the rules for donations of proceeds from the sale of shares acquired under eligible stock options. Under those rules, the taxpayer can direct a broker, who issues stock option shares and sells them, to transfer all or part of the proceeds directly to a charity. The rules contemplate that the sale proceeds will not be paid to the taxpayer, but transferred "immediately" by the broker directly to the charity. If only a part of the proceeds are transferred directly by the broker to the charity, the amount of the donation is pro-rated and determined as if only some of the shares acquired under the option had been donated. This seems to be similar to the concept in the 2015 proposals.

It is not clear if the taxpayer will be able to sell the shares or real estate other than for cash, but within 30 days make a cash payment based on the sale proceeds, using other funds. Money is fungible and the funds received from the sale will rarely be identifiable as the same "cash proceeds" that are donated. Under the proposals "cash proceeds from the disposition" of the shares or real estate must be donated within 30 days after the disposition. This suggests the sale must be for cash and the same cash received on closing must somehow be segregated and transferred directly to the charity. It is not clear if this will require some form of escrow on closing, so the sale proceeds (presumably net of related expenses) can be donated directly and not intermingled with other funds. Lawyers' trust accounts may often be involved in a closing, with "cash proceeds" losing their identity. Perhaps the sale must be only for cash but the cash donated need not be traced directly to the sale. The legislation will presumably clarify this. If taxpayers are required to sell only for cash, the pool of buyers may be more limited. Allowing the taxpayer to donate cash derived from any source within 30 days after the sale would seem to offer a broader incentive and the anti-avoidance rules could presumably address potential abuse from arm's length sales for non-cash consideration.

Under the proposed anti-avoidance rules, the exempt gain will be taxable if within five years after the disposition, the donor or a non-arm's length person reacquires the property or, in the case of shares, the donor or a non-arm's length person acquires "substituted" shares, or the shares are redeemed and the corporation and the donor are not dealing at arm's length at that time. These rules will presumably be flushed out in more detail when the legislation is introduced, as will the rules dealing with the tracing of the cash proceeds.

CAVEAT

This summary is of a general nature only, is not intended to deal with all Canadian income tax considerations. It is not intended to be, and should not be construed to be, legal or tax advice to any particular reader. Therefore, readers should consult their own tax and legal advisers with respect to their particular circumstances.

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