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Planned giving provides benefits for charities and donors alike

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2003

PLANNED GIVING PROVIDES BENEFITS FOR CHARITIES AND DONORS ALIKE

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Masters Series

This is one of a series of articles prepared for CIBC Private Wealth Management™. The series is written by professionals in such fields as taxation, trusts, and estates.

Philanthropy is an important objective of many Canadians. By being aware of the tax implications of different planned giving structures, donors can plan to maximize the benefits for everyone involved.

Donating to charity can be as simple as sending a cheque to a local hospital or university, or it can be a more complex and integral part of an overall estate plan. In the pages that follow, you will find a brief description of the main types of charitable giving, as well as a discussion of the special tax and estate planning advantages of each.

Inter vivos gifts

When you donate to your favourite charity — whether your local religious congregation or a large national charity — you are contributing towards building and strengthening your community. While you don't always make your donations to obtain a tax break, the tax benefits of a charitable donation mean that the "real" cost to you, the donor, can be as low as 55% of the amount of the donation, depending on your province of residence.

Under the Income Tax Act, the first $200 of annual donations provides you with a federal tax credit of 16%; for donations in excess of $200, you receive a 29% federal tax credit. When you factor in the provincial credit, this can add up to a tax credit of approximately 33% to 48%. For gifts made during your lifetime (other than those made in the year of death

Gifts of publicly listed securities

Ordinarily, when you sell or transfer publicly listed securities that have appreciated in value, you will trigger a taxable capital gain. Where the shares (or certain types of ecologically sensitive land) are donated to charity, however, the income inclusion is one-half of the normal amount. So, if you sold, say, bank shares, with an accrued gain of $10,000, your income inclusion would be $5,000; if you donated the shares, your income inclusion would be $2,500.

This article was prepared by the Charities and Not-for-Profit practice group of Miller Thomson LLP, a full-service law firm. Miller Thomson LLP's National Charities and Not-for-Profit practice group represents charities and not-for-profit organizations, as well as public and private foundations in the voluntary sector. This practice group has substantial experience in gift and tax planning, as well as structuring endowment programs, and also represents charities and not-for-profit organizations in litigation matters.

and the year before the year of death), the maximum donation that can qualify for credit each year is 75% of net income (with some exceptions). If the amount of the donation exceeds the 75% limit, you can carry forward the remaining amount for up to five years.

Gifts of life insurance

A donation of a life insurance policy allows you to leave a significant legacy to your favourite charity for a relatively modest annual payment.

There are two basic methods. The one that you choose will depend to a large extent on the type of tax benefit you desire:

Gift of life insurance during the donor's lifetime. If you wish to obtain an immediate tax break, you can transfer ownership of an existing policy to the charity; the charity, in turn, becomes the beneficiary of the policy.

If the donation is of a permanent life insurance policy with accumulated cash value, the charity will issue a tax receipt in the amount of the cash surrender value of the policy at the date of transfer, which should more than offset tax that may arise on the transfer. Further, the charity will issue receipts for any premiums that you pay following the transfer. Note, however, that no receipt is issued for the death benefit that is paid to the charity on the death of the life insured because the charity, rather than the donor, is the owner of the policy.

In a variation of this scenario, you can purchase a new policy and donate it to the charity. Tax receipts will be issued annually for the amount of the premiums you pay following the transfer of the policy to the charity. No receipt is issued for the death benefit.

Gift of proceeds on death. If you are expecting a large tax bill on death, perhaps arising from the deemed disposition of shares of a successful family business, you may prefer this second method. You would retain ownership of the life insurance policy throughout your lifetime. You would name the charity as the beneficiary of the policy and on your death, the charity would receive the insurance proceeds. The charity would issue a tax receipt in the amount of the proceeds of insurance. This receipt would be available to offset any taxes that arise on your death.

This approach provides the following benefits:

- The proceeds of the insurance policy are not included in your estate for probate purposes, nor available to most creditors of the estate.
- The proceeds go directly to the charity; distribution is not delayed by estate litigation.
- By making the donation outside a will, which becomes a public document once probated, you can remain anonymous, if desired.
- If you have a change of heart, you would simply change the beneficiary designation.

Keeping up the premiums

When receiving a gift of life insurance, the charity will usually want to ensure that sufficient premiums are paid throughout the lifetime of the life insured so that the policy does not lapse.

To keep track of the payments, some charities prefer to have the donor send the annual premium payment to them. They, in turn, remit the payment to the insurance company. Other charities ask the donor to remit the premiums directly to the insurer.

If the donor defaults, the charity, as owner of the policy, could consider paying the premiums to keep the policy in force until the death of the life insured. Alternatively, the charity could collapse the policy and obtain the accumulated cash surrender value. Provided that the policy remains in force until your death, the charity would receive the death benefit directly from the insurer.

Bequests

A bequest to charity in a will can be a tax-effective strategy that benefits a favourite charity without tying up your capital during your lifetime.

A person's tax bill on death is often much higher than during his or her lifetime. On death, you are deemed to have disposed of all capital property owned at the time of death. Any capital gains that have accrued on this property become taxable in your "terminal tax return," unless the property is left to your spouse. In addition to the taxable capital gains that are reported in the terminal return, the value of any Registered Retirement Savings Plans (RRSPs) or Registered Retirement Income Funds (RRIFs) owned by the deceased are included in income unless left to a spouse, or dependent child or grandchild, even though the proceeds may be paid out directly to a named beneficiary.

When you leave a bequest to a designated charity in your will, depending on the terms of the gift, your estate may be able to use the charitable tax credit in the terminal tax return for donations up to 100% of net income. If the amount of the donation exceeds your net income in the year of death, the remaining amount of the donation (again, up to 100% of net income) can be carried back to the previous tax year and used to reduce taxes paid or payable in that year.

The bequest in your will can be for a fixed amount (legacy), a percentage of the remainder of your estate, or all of the remainder. It may be made outright or contingent upon the death of an individual, such as your spouse, who is entitled to the income (and capital) of your estate during his or her lifetime.

It is important to name the charity accurately and specifically in your will, in order to prevent a dispute between similarly named charities and to ensure that the intended charity receives the donation.

Charitable remainder trusts

Establishing a charitable remainder trust (CRT) will allow you to receive a donation credit during your lifetime, while continuing to receive an income stream from the assets that are donated.

You can establish a CRT by transferring assets (cash, shares, GICs, or other types of property) to a Trustee, often a trust company. You (or another individual, such as your spouse) can be the beneficiary of the income (the "income beneficiary") of the CRT for life, or for a specified number of years; the charity is the beneficiary of the capital of the CRT.

The Trustee manages the assets and pays out all of the income generated to the income beneficiary, who pays tax on it. The income beneficiary has no rights to encroach on the capital of the trust property, which ultimately will be paid out to the charity when the trust terminates.

The charity issues a charitable tax receipt at the time the CRT is established. The amount receipted is the present value of the charity's remainder interest — calculated based on the age of the donor and other factors. The assistance of an actuary is required by a charity to determine the value of the gift for tax purposes. Establishing and maintaining CRTs can be complex, so it is important to involve the charity early on when considering a CRT.

You must be cautious when setting up a CRT. A CRT is irrevocable. You will give up control over the assets and cannot change either the income or the capital beneficiaries.

Private foundations

Another vehicle for charitable giving is the private foundation. These charities are often established by an individual or a family with the goal of receiving charitable gifts from family members. The foundation's funds are then either given immediately to other registered

Legislation under review

If you donate property that has increased in value to a charitable remainder trust, you will be required to pay tax on the property's accrued taxable capital gains in the year the gift is made. While the donation receipt may offset the tax on the capital gains realized, it might not be sufficient to cover the entire amount in every situation.

In the past, the Canada Customs and Revenue Agency (CCRA) has provided limited administrative relief where the donation receipt does not offset the amount of the income inclusion; however, it must be noted that the CCRA has advised that the administrative position is currently under review (as of November 6, 2003).

charities or are accumulated for some period of time in the foundation prior to being given to other registered charities. (A minimum amount of the foundation's funds must be spent each fiscal year on charitable activities or grants.)

A private foundation is a particularly good vehicle for charitable giving when the donor wants to control the investment or the use of the donated funds. Private foundations are also attractive to donors who want a lasting organization bearing their name.

Of course, there are legal and accounting compliance costs to setting up and maintaining a private foundation. However, in the context of a significant gift (typically, $5 million to $10 million or more), these should not be a barrier to the establishment of a private foundation.

A more significant hurdle in the context of a private foundation is that the tax consequences of some types of charitable gifts (particularly charitable gifts of appreciated publicly traded shares) are not as attractive if the gift is made to a private foundation, as compared to other charities.

Professional advice is highly recommended for this strategy, as well as the other planned giving strategies outlined above.

The material in this article is provided for informational purposes only and is not intended to be legal advice or a legal opinion but as information only. Readers are cautioned not to act on information provided without seeking specific legal and other professional advice with respect to the particular situation.