ESTATE AND CHARITABLE GIFT PLANNING

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1. INTRODUCTION

Trusts are a useful tool for designing an estate plan that works within the constraints imposed by law and each client's unique set of circumstances. In particular, alter ego trusts and joint partner trusts are frequently referred to as "will replacements" and are useful estate planning tools in jurisdictions where probate fees are high and dependants' relief legislation is a concern. However, there are significant differences between charitable gifting by will and gifting through such trusts. Making charitable gifts through these trusts requires careful planning to ensure the gifts are properly effected and that the tax benefits of the gifts can be realized.

In this paper, we will provide an overview of common estate planning challenges which trusts may be used to mitigate, as well as some common trusts used by estate planners. Then, this paper will focus on the income tax treatment under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "ITA") of charitable donations made by trusts for estate planning purposes and the key considerations for charitable gifting planning, including to whom tax effective gifts can be made, what types of gifts are commonly made, when these gifts should be made and how they should be made to maximize a trust's tax benefits from a charitable gift. Finally, we will go through some specific challenges and tips in relation to charitable gifts made by alter ego and joint partner trusts.

2. ESTATE PLANNING THROUGH TRUSTS

(a) COMMON ESTATE PLANNING CHALLENGES

(i) INCOME TAX AND PROBATE FEES

A goal of every estate plan is to minimize or defer taxes while staying true to the client's preferred disposition scheme. Tax liability arises under the ITA when, *inter alia*, a taxpayer disposes of capital property or is deemed to dispose of capital property. A disposition occurs when property ownership is transferred, for example, by way of a sale, gift, or (in most cases) a transfer into a trust. Under subsection 70(5) of the ITA, an individual is deemed to have disposed of all of his or her capital property for its fair market value immediately before his or her death and as a result the individual's estate will be liable to pay tax on capital gains which have accrued since the individual acquired the property. This can lead to serious consequences for even modest estates, particularly if no other provisions of the ITA apply to defer or exempt the tax on capital gains. Under subsection 104(4) of the ITA, a deemed disposition of the capital property for fair market value occurs on the death of the settlor in the context of an alter ego trust, the death of the survivor of the settlor and his or her spouse or common-law partner in the context of a joint partner trust, and the death of the spouse or common-law partner in the context of qualified spousal trust. As we will discuss, it is sometimes possible to minimize this tax through charitable giving by a trust.

In the estate administration process, further tax liability may arise pursuant to the *Probate Fee Act*, S.B.C. 1999, c. 5 (the "*Probate Fee Act*"). When the personal representative of a deceased person applies to the court for a grant of probate of a will, probate fees are charged against assets of the deceased's estate passing to the personal representative, including all tangible property located in British Columbia and, in the case of British Columbia, intangible property located worldwide. Fees are calculated at 0.6% for the value of an estate between $25,000 and $50,000 and at 1.4% for the value of an estate over $50,000, which means that an estate worth $1 million would incur probate fees of approximately $14,000. For many people, avoiding probate fees is a goal of their estate plan. Assets passing outside an estate (including through *inter vivos* trusts) are not subject to these fees.

(ii) PROBATE DELAYS AND PRIVACY CONCERNS

The probate process also results in additional legal costs and delays in the estate administration, and requires the deceased person's personal and financial information to be filed in a public court record. As well, mandatory notices and copies of the will must be sent to people and entities named in the will, as well as to any person who would benefit from the estate if the deceased had died without a will. For all these reasons, an individual may wish to create a plan which does not require a personal representative to obtain a grant of probate upon his or her death. By settling a trust during his or her lifetime, an individual may be able to dispose of assets which would otherwise require a grant of probate to be issued if they were administered in the estate. Once transferred into the trust, these assets would simply be held and distributed according to the terms of the trust.

(iii) PLANNING FOR COMPLEX FAMILY CIRCUMSTANCES AND INCAPACITY

A trust may also be a useful vehicle for dealing with issues arising from one's family circumstances. Challenges can arise when planning in the context of blended families or when people are making provisions for minor children, beneficiaries with disabilities or beneficiaries who are simply unable to manage money. In many of these circumstances, an individual may wish to provide support or make gifts to a beneficiary without granting him or her the responsibility or control inherent in outright ownership of property. Trusts provide a mechanism for making such provisions while allowing an individual to maintain control over how and when property is received by the beneficiary and who manages it in the meantime.

Trusts can similarly be useful tools for planning for the end of life and the possibility that an individual may become incapable of managing his or her own financial affairs in the future. One option in these circumstances is for the individual to settle a trust (while he or she is still capable) which empowers a trustee to administer a trust for the benefits of the individual during his or her lifetime.

(iv) WILLS VARIATION CLAIMS

In British Columbia, an individual may also need to consider potential wills variation claims under the *Wills, Estates and Succession Act*, S.B.C. 2009, c. 13 ("WESA"). Under section 60 of WESA, the spouse or child of a will-maker is entitled to bring a claim on the basis that the will does not adequately provide for him or her and the court has the authority to vary the will to make provision it thinks is adequate, just and equitable in the circumstances. However, the court's power is limited to redistributing property passing under a will and it is possible to foreclose potential wills variation claims by settling property into a trust during the individual's lifetime so that it passes outside his or her will.

However, while property held in a trust outside of a will-maker's estate may be safe from direct claims under WESA, this property may be vulnerable to attacks on the trust's validity or to creditors' or other's claims, including claims for unjust enrichment, or the claim of a spouse under the *Family Law Act*, S.B.C. 2011, c. 25. In some circumstances, it may be possible for a claimant to prove that the transfer into a trust was made "to delay, hinder or defraud creditors" under the *Fraudulent Conveyance Act*, R.S.B.C. 1996, c. 163, in which case the transfer would be void and the property would form part of the client's estate, where it would become subject to a wills variation claim.[1]

(b) *INTER VIVOS* TRUSTS VS TESTAMENTARY TRUSTS

(i) *INTER VIVOS* TRUSTS

Some general legal advantages to settling a trust during lifetime (an "*inter vivos* trust") include: property held in trust will pass outside the individual's estate and therefore will not be subject to the probate process, probate fees or wills variation claims; a settlor can choose successor trustees to manage property on behalf of the beneficiary (including him or herself) even if the beneficiary is or becomes incapable; and assets held in trust can have some greater privacy.

However, there are some practical disadvantages to settling an *inter vivos* trust. The settlor may not have the same degree of control over property held in trust that he or she has over property that is owned absolutely. Alter ego and joint partner trusts are notable exceptions. Sometimes a settlor simply forgets that property is held in trust or becomes frustrated that additional steps are necessary to deal with or distribute property. Generally, it is more expensive to settle an *inter vivos* versus a testamentary trust and settling an *inter vivos* trust will create administrative costs and burdens during the settlor's lifetime.

Further, there may be negative tax consequences for settling an *inter vivos* trust, which are taxed at the highest marginal rate for individuals on income retained in the trust although this is typically easily avoided. In many circumstances, the transfer of property to a trust (other than an alter ego or joint partner trust) will be a deemed disposition at fair market value, which may result in tax on accrued capital gains. If an attribution rule applies, the settlor may also continue to be liable for tax on income and capital gains.

(ii) TESTAMENTARY TRUSTS

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[1] See *Antrobus v. Antrobus*, 2009 BCSC 1341, aff'd 2010 BCCA 356, where the court set aside a trust settled by the claimant's parents; the claimant successfully proved a claim for unjust enrichment based on her contributions to the parent's business. See also *Mawdsley v. Meshen*, 2010 BCSC 1099, aff'd 2012 BCCA 91, and *Easingwood v. Cockcroft*, 2011 BCSC 1154, aff'd 2013 BCCA 182 ("*Easingwood*"), where spouses attempted to set aside transfers to trusts on the basis of their spousal status. In *Easingwood*, the court made clear that a spouse must have a potential right or claim to family assets to have a claim under the *Fraudulent Conveyance Act*.

A testamentary trust is defined under subsection 108(1) of the ITA as a trust arising on or as a consequence of the death of the individual who created it. For the purposes of the ITA, testamentary trusts include, *inter alia*, the estate of an individual, a trust created under the will of an individual or by a court order under WESA (under paragraph 249(9.1)(a)), and an insurance trust if funded with proceeds of life insurance.

There are a number of practical advantages to an individual retaining absolute ownership during his or her lifetime and creating a testamentary trust to arise on death: the legal costs of settling a testamentary trust are often lower than those involved in *inter vivos* trust planning and there are no additional administrative costs or burdens during his or her lifetime. However, the individual can still take advantage of many of the benefits of holding property in trust, including albeit only upon and after death providing for minors or beneficiaries with disabilities, preserving capital for multiple generations and protecting against the creditors of beneficiaries.

Historically, testamentary trusts enjoyed the same graduated tax rates as individuals and could choose their own year end for tax purposes. However, since changes to the ITA implemented in 2016, only two types of testamentary trusts enjoy graduated tax rates: a graduated rate estate ("GRE") [2], which refers to the estate of an individual during no more than the first 36 months following the date of the individual's death, and a qualified disability trust, which is described below. GREs also have a choice of year-end.

As we will discuss, if a charitable gift is made in a will or by an estate and the estate is a GRE, then some beneficial tax treatment, which is not available to any other types of trust, would be available for the estate.

(c) "LIFE INTEREST" TRUSTS

[2] The term of "graduated rate estate" is defined in subsection 248(1) of the ITA. Beginning on December 31, 2015, a graduated rate estate of an individual at any time is the estate that arose on and as a consequence of the individual's death, if that time is no more than 36 months after the death of the individual and the estate is at that time a testamentary trust. As there can be only one graduated rate estate in respect of a deceased individual, for an estate to be an individual's graduated rate estate, the following conditions must also be satisfied:

- the estate must designate itself, in its T3 return of income for its first taxation year (or if the estate arose before 2016, for its first taxation year after 2015), as the individual's graduated rate estate;
- no other estate can have designated itself as the graduated rate estate of the individual; and
- the estate must include the individual's Social Insurance Number in its return of income for each taxation year of the estate that ends after 2015 during the 36 month period after the death of the individual.

The ITA gives special tax treatment to a number of trusts which exclusively benefit certain beneficiaries (i.e. life tenants) during their lifetimes and which are known as "life interest" trusts. The two "life interest" trusts that are most relevant to this paper, defined under subsection 248(1) of the ITA, are:

(a) An alter ego trust, which benefits the settlor during his or her lifetime; and

(b) A joint spousal or common-law partner trust (collectively, "joint partner trust"), which benefits the settlor and his or her spouse or common-law partner during their lifetimes.

Alter ego and joint partner trusts must be settled *inter vivos*. Under subsections 248(1) and 104(4) of the ITA, the following requirements must be met to settle an alter ego or joint partner trust:

- The settlor must be a Canadian resident who has attained the age of 65 years;
- The trust must be a Canadian resident and created after 1999;
- The life tenants (i.e. the settlor in the context of an alter ego trust, the settlor and his or her spouse or common-law partner in the context of a joint partner trust) must be entitled to receive all of the income of the trust during his, her or their lifetimes; and
- No other person may be entitled to income or capital from the trust during the lifetime(s) of the life tenant(s).

If a spouse or common-law partner of the original settlor also contributes property to a joint partner trust, he or she must also be a Canadian resident and have attained the age of 65 years at the time the contribution is made.

Unlike transfers to most other *inter vivos* trusts, a tax-deferred rollover is available when property is transferred to an *inter vivos* "life interest" trust under subsections 73(1) and (1.01) of the ITA. Under subsection 104(4) of the ITA, a deemed disposition of the capital property for fair market value occurs on the death of the settlor in the context of an alter ego trust, and the death of the survivor of the settlor and his or her spouse or common-law partner in the context of a joint partner trust. Under subsection 104(13.4) of the ITA, there is a deemed tax-year end on the death of the relevant life tenant. This means that tax on capital gains will be deferred to the death of the settlor or the death of the settlor's spouse or common-law partner, depending on the circumstances and the type of trust employed. The disposition is in the trust, so it is the trust that bears the tax burden. There is also a deemed disposition of capital property every 21 years after the death which triggers the first deemed disposition.

The attribution rule in section 75(2) of the ITA often applies to "life interest" trusts, such that income and capital gains and losses will be attributed to the settlor during his or her lifetime. There are also some potential disadvantages that can occur after the death of the life tenant(s): since the deemed income on the death of the relevant life tenant is taxed in the trust, it will be taxed at the highest marginal rate on every dollar and the settlor will not be able to utilize his or her lifetime capital gains exemption on qualified farm or fishing property and qualified small business corporation shares. If property is held in an alter ego trust, it cannot be transferred to a surviving spouse on a tax-deferred basis after the death of the life tenant. Also, successive trusts cannot likely qualify for testamentary status, which may create problems when a beneficiary with disabilities has a remainder interest since he or she could otherwise benefit from a qualified disability trust.

However, there are a number of practical reasons for settling a "life interest" trust: the property held in trust will not pass through the estate of the settlor or, in the context of a joint partner or qualified spousal trust, through the estate of the settlor's spouse or common-law spouse, and will not be subject probate fees or the delays of the probate process. "Life interest" trusts also provide some protection to beneficiaries from creditors' claims and wills variation claims. Further, the life tenant(s) continue to benefit from the property during his, her or their lifetimes and a trustee other than the life tenant(s) can manage the property in the event that life tenant(s) become incapable.

Alter ego and joint partner trusts are useful in the context of blended families, as a settlor can ensure that his or her spouse benefits from the estate during the spouse's lifetime and also that all or some portion of the capital of his or her estate passes to other beneficiaries (such as children from another relationship) on the death of the spouse.

3. TAX PLANNING AROUND CHARITABLE GIFTS IN RELATION TO TRUSTS

As a general rule, tax benefits are available when an individual makes a gift to a “qualified donee”. A trust is an individual under subsection 248(1) of the ITA and can make a charitable gift. Where the trustee has the discretion to make or not make a transfer to charity on behalf of a trust then the transfer will generally be characterized as a gift. As a gift, it then qualifies as a charitable donation and the trust will be allowed to claim a non-refundable charitable donation credit against its taxes payable under subsection 118.1(3) of the ITA.

(a) TAX CREDITS FOR CHARITABLE DONATIONS

If the donation meets the requirements for a charitable gift, section 118.1 of the ITA provides for a non-refundable tax credit to individuals, including trusts, in respect of charitable donations to certain registered charities. Under subsection 118.1(3) of the ITA, a trust (other than a GRE or a “qualified disability trust”) is entitled to a two-tier tax credit. The first $200 of annual donations produces a 15% federal tax credit, plus the applicable provincial/territorial credit. Donations above that level produce a 33% (i.e. the highest individual tax rate) federal tax credit, worth 44.5% to 54.0% when provincial/territorial credits are factored in.

Pursuant to the definition of “total gifts” in subsection 118.1(1) of the ITA, the amount of charitable donations that is eligible for the donation tax credit is limited to 75% of net income plus, among other things, 25% of any taxable capital gain or recapture resulting from the donation of capital property. However, owing to an interaction of the definitions of “total gifts” and “total charitable gifts” in subsection 118.1(1) of the ITA, the 25% increase does not apply in the following situation:

(a) the taxable gain or recapture results from a deemed disposition of the capital property on the death of a beneficiary, and

(b) the property is held by a life interest trust (for example, a spousal trust or an alter ego trust).[3]

If a trust has donation receipts that exceed its income limit, or if a trust chooses not to claim a donation in the year it made it for other reasons, the trust can save the receipts and generally claim

[3] CRA Views, Interpretation—external, 2019-0799641E5 -- Gift by life interest trust (January 27, 2020).

the credit in any of the following five years under clause (c)(ii)(A) of the definition of "total charitable gifts" in subsection 118.1(1).

By contrast, 100% of the individual's net income is eligible for the donation tax credit for the year in which the individual dies and for the taxation year preceding death under subparagraph (a)(ii) of the definition of "total gifts" in subsection 118.1(1).

(b) THREE TYPES OF REGISTERED CHARITIES

The issuance of donation receipts is restricted to registered charities approved by the CRA. As defined in subsection 149.1(1) of the ITA, there are three basic types of registered charities:

(a) charitable organizations,

(b) public foundations, and

(c) private foundations.

Different types of registered charities receive different treatment under the ITA, and thus some may be better suited for the type of planning needed by a particular individual than others. Among the three types, private foundations are of particular relevance to estate planners because some beneficial tax consequences available to charitable organizations and public foundations are not available to private foundations, in particular, those benefits with respect to private company shares and debts, which will be discussed below.

A private foundation is defined in subsection 149.1(1) of the ITA as a charitable foundation that is not a public foundation. Private foundations usually meet their charitable activity requirements ("disbursement quota") by funding other charities. A private foundation generally receives more than 50% of its funding from related donors and/or more than 50% of its Board of Directors are related to each other. Private foundations may be established by individuals and utilized to make *inter vivos* gifts as well as to make post-mortem gifts through a will or a trust. In effect, an individual can establish his or her own charity and then give to that charity. The private foundation can in turn distribute the funds received to other registered charities. In creating such a foundation, however, care must be taken to ensure that the foundation's activities and purposes meet the definition of a "charitable foundation" in subsection 149.1(1) of the ITA.

The primary estate planning benefit of establishing a private foundation is the flexibility and control afforded to the would-be donor. The creator of the foundation can control the foundation's functions. Even after a gift to a private foundation is made, the charities to be benefited by the foundation can be changed. The ability to change focus after a gift is made is of particular value where a bequest is made in a will or a trust. As well, *inter vivos* donations can be made in the manner most beneficial to the donor in terms of both types of donation and timing of donation.

(c) SOME COMMON TYPES OF GIFTED PROPERTY

Charities can receive all manner of property as donations. The type of property given will have a bearing on the tax treatment of the gift and the type of tax benefit that can be achieved by making such a gift.

(i) CASH

Donations of cash are the simplest form of a charitable donation an individual can make. They are simplest both with respect to the actual making of the gift and the valuation of the gift for the purposes of obtaining a donation receipt. It is relatively easy to prove that the gift has been made and the value of the gift is the face value of the cash, unless of course the actual notes or coins given have some intrinsic value beyond their face value. There is no capital gain associated with a gift of cash and thus the gift itself does not add to the taxable income of the donor. In spite of the simplicity of cash gifts, a donation of cash to charities does not provide any opportunity to receive additional tax benefits beyond the straight calculation of credits based on the monetary amount.

(ii) PUBLICLY TRADED SECURITIES

Pursuant to paragraph 69(1)(b) of the ITA, where a person, including a trust, makes a gift of property, it is deemed to receive proceeds of disposition equal to the fair market value of the property. Under paragraph 38(a.1) of the ITA, gifts of eligible securities to a qualified donee, including securities listed on a designated stock exchange, mutual funds and segregated funds of life insurance companies, are exempt from the triggering of capital gains from the deemed disposition.

These rules apply to donations of publicly traded securities to private foundations as well as public charities, though private foundations are subject to tighter restrictions under the ITA, which are referred to as the Excess Corporate Holdings Regime (as discussed in 4(f) below), on the amount of shares they (after taking into account non-arm's-length party holdings) can own in a corporation.

(iii) PRIVATE COMPANY SHARES

(A) EXCEPTED GIFTS

Private company shares do not get the same beneficial treatment as publicly traded securities. Gifts of private securities that fall within the class of "excepted gifts" as defined in subsection 118.1(19) of the ITA qualify as charitable gifts for the purposes of receiving donation tax credits, but do not receive the preferential treatment accorded to publicly traded securities, i.e. the exemption from triggering the capital gains. The "excepted gifts" are gifts of shares where the following conditions are met:

(a) the donee is not a private foundation;

(b) either,

if the doner is an individual's GRE, the individual deals at arm's length with the donee immediately before his or her death and the GRE deals at arm's length with the donee; or

in any other circumstances, the doner deals at arm's length with the donee; and

(c) where the donee is a charitable organization or public foundation, the donor deals at arm's length with each of the principal actors of the donee.

While they do not receive the preferred status of publicly traded shares, excepted gifts give rise to donation tax credits as any other charitable gift.

(B) NON-QUALIFYING SECURITIES

There is, however, an explicit bias in the ITA against gifts of "non-qualifying securities". Subsection 118.1(13) of the ITA provides that where an individual (including a trust) makes a gift of a non-qualifying security that would otherwise be a charitable gift giving rise to a donation tax credit and the gift is not in that class of "excepted gifts", the gift is deemed not to have been made.

In other words, where an individual makes a gift of a non-qualifying security, the gift never occurred for the purposes of donation receipting and therefore no donation tax credit is available. A non-qualifying security is generally defined in subsection 118.1(18) of the ITA as a share, debt obligation or other security issued by the donor or non-arm's-length person, generally, private company shares where the donor does not deal at arm's length with the private company. Thus, wherever an individual has a debt obligation or share in a corporation, or someone with whom they are not dealing at arm's-length has such a security, and that security is given to a charity in a manner that is not an excepted gift, no gift will have occurred and, thus no tax benefit exists. Obviously, gifts of non-qualifying securities are not precluded by subsection 118.1(13), but no tax benefits will be received for such. It should be noted that if a gift of a non-qualifying security ceases to be non-qualifying within 60 months of the donation or the donee disposes of the security within 60 months for consideration that is not anyone's non-qualifying security, the donor may be deemed to have made a valid charitable gift at that time pursuant to paragraphs 118.1(13)(b) and (c) of the ITA.

The most obvious and prevalent example of a gift of a non-qualifying security is a gift of private company shares to a private foundation. These shares must essentially converted to cash within five years of the gift to obtain a charitable donation receipt.

One example of denial of the donation tax credit where a gift of non-qualifying securities was made to a non-arm's length private foundation is the recent Tax Court's decision in *Odette (Estate) v. The Queen*[4]. Mr. Odette died in 2012 and as part of an estate plan about $17 million in shares of Mr. Odette's private company were donated to a private foundation in 2013. The court found that

> "The private foundation then disposed of the shares to Mr. Odette's company in exchange for a promissory note of that company [in the same year]. The company made corresponding cash payments within approximately eight months of the disposition."

The key issue was a review of section 118.1(13)(c) of the ITA and whether the phrase "any consideration" includes a promissory note. The court decided that it did not and rejected the official

[4] *Odette (Estate) v. The Queen*, 2021 TCC 65.

donation receipt even though the estate had actually later made cash payments to the private foundation of $17 million. The logical inference from the decision is that had there not been a promissory note and the $17 million been paid directly for the shares there would have been no particular problem with the transaction.

The court found that:

> "a textual, contextual purposeful analysis of paragraph 118.1(13)(c) of the Act indicates that the term "any consideration" is limited. The consideration must be received at the time of the disposition and it must not be a non-qualifying security. … the only consideration received for the disposition of the shares was the promissory note. Since the promissory note was between non-arm's length parties, it is a non-qualifying security. Thus, paragraph 118.1(13)(c) deems the fair market value of the shares to be nil and the Appellant [Mr. Odette's estate] is not entitled to the charitable donation tax credit."

(d) HOW TO GIVE - GIFT OR DISTRIBUTION

Some transfers of trust property from trustees to a qualified donee will be gifts and some will not for the purposes of the ITA. The most significant issue that arises when making a charitable donation from a trust is to ensure that the trust agreement is properly drafted to ensure that the gift to charity will be considered a donation and not a distribution to a beneficiary.

The term "gift" is not defined in the ITA. Therefore, reference is made to the common law principles. Under the common law, "a gift is a voluntary transfer of property owned by a donor to a donee, in return for which no benefit or consideration flows to the donor"[5]. Generally, for purposes of sections 110.1 and 118.1 of the ITA, the CRA takes the position that a gift under common law is made if a taxpayer has donative intent, and all three of the following conditions are satisfied:

- there must be a voluntary transfer of property to a qualified donee;
- the property transferred must be owned by the donor; and

[5] *The Queen v Friedberg*, [1992] 1 C.T.C. 1 (FCA) 92 D.T.C. 6031.

- no benefit or consideration must flow to the donor.[6]

As part of the definition given to the word "gift", a gift to charity must be a voluntary act. If the amount and timing of a charitable transfer is mandatory under the trust terms, the CRA's position is that the payment is simply the satisfaction of the charity's interest in the trust and not a charitable gift.[7]

To effectively make a gift through a trust, significant discretion must be given to the trustee. The distinction between a trust agreement giving the trustees the power to make a charitable gift and requiring them to make a gift is crucial. If a specific charity is named in a trust agreement as a beneficiary, the CRA has indicated that it might not consider the gift to a charity to be a donation but rather a distribution to a beneficiary. If the gift is considered a distribution to a beneficiary, the result is that there will be no donation tax credit available to the trust for that gift.[8] On the other hand, the CRA has accepted that, where the facts lead to a determination that the trustee is clearly given the discretion to decide if a payment is to be made to a charity or to have the funds used in some other manner, the payment is considered voluntary.[9] The determination depends upon the specific wording of the trust agreement and the intentions of the trustee in making the payment to the charity.[10] Arguably, if a charity is named as a beneficiary in a trust agreement, it can demand that the trustee distribute the property to which it is entitled. If the decision to donate is a purely discretionary power held by the trustee, no charity can demand that a distribution be made.

To ensure that a gift from a trust is not viewed as a distribution but rather as a donation, there are two important considerations. First, the trust agreement must include a general power to donate trust property. Second, the trustee should be given full discretion as to (1) whether to make a charitable gift, (2) which charities to benefit; and (3) the quantum of any gift. These three aspects together will ensure, to the extent possible, that the gift will be viewed by the CRA as a gift for which a donation tax credit is available.

[6] Income Tax Folios, S7-F1-C1 -- Split-receipting and Deemed Fair Market Value.
[7] Technical Interpretation 2003-0182905, *Gifts of Interest in Alter Ego Trust* (December 11, 2003).
[8] CRA Views, Conference, 2019-0798491C6 -- STEP 2019—Q2—Alter ego trust and donations (June 7, 2019).
[9] *Ibid.*
[10] *Ibid.*

As specific charities generally cannot be named as beneficiaries in the trust agreement, a settlor may wish to consider executing a letter of wishes outlining the charities he or she would like the trustee to benefit. While it is not legally binding, such a letter is morally persuasive and particularly where a financial institution is the trustee, a letter of wishes can provide much needed direction.

(e) DISTRIBUTION FROM TRUSTS

(i) CAPITAL DISTRIBUTION

Where a trustee is obliged to make a transfer of capital to a qualified donee, by mandatory terms in the trust stipulating that the gift be made, then the transfer will not qualify as a charitable gift by the trustee on the part of the trust but will be characterized as a capital distribution. In this case, there would be no charitable tax relief in favour of the trust.

This situation occurs, for example, when a transfer of capital is to be made from an alter ego trust to a charity on the death of the settlor. If the charity is specified under the terms of the trust, and there is no discretion on the part of the trustees to vary the amount to be gifted, then the transfer to charity will be characterized as a capital distribution and not as a charitable gift.[11] Thus the trustees cannot use the gift to reduce taxes on the T3 Return.

Subject to some exceptions, the settlor is precluded from taking advantage of the tax receipt as well. In the act of settling the trust, the settlor is transferring assets to the trustees, not making a gift to a qualified donee. Denied to both the trust and the settlor, the tax relief normally expected from the gift to charity may be unavailable to everyone involved and the potential tax relief could be wasted. The mere fact that a charitable receipt has been issued by the qualified donee does not mean that the transfer from the trust to the charity can be claimed as a charitable gift.[12]

An exception applies to a gift that can be characterized as being to a charitable remainder trust. Under a charitable remainder trust (as discussed in 4(e) below), a mandatory distribution to charity is stipulated to occur, but the date of that distribution is postponed. In this case, the settlor will be entitled to claim a charitable donation in the year he or she settles the trust based on the present value of the future gift.

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[11] *Ibid.*

[12] Technical Interpretation 2003-0023835, "Charitable Donations" (November 21, 2003).

(ii) INCOME DISTRIBUTION

If the charity is an income beneficiary of the trust, the trust can still deduct the income distributed to the charity under subsection 104(6) of the ITA. The income distributed would not be taxed in the trust's hands and since the income would be considered to be that of the charity (which is tax-exempt), no tax would be payable on that amount. However, this deduction will not be available to provide relief against the tax arising as a result of the deemed disposition of the trust property on the death of the settlor (in the case of an alter ego trust) or the survivor of the settlor and his or her spouse (in the case of a joint partner trust) by virtue of paragraphs 104(4)(a) and 104(6)(b) of the ITA.

(f) CHARITABLE GIFTS MADE BY AN ESTATE

Different rules apply to gifts made by an estate. Prior to 2016, a charitable gift made by an estate pursuant to the will of the deceased individual is deemed to have been made by the deceased individual immediately prior to death. Therefore, the donation must be claimed in accordance with the rules for donations made in the year of death by the deceased individual, and not by the estate. The new rules under subsections 118.1(4.1) and (5) of the ITA applicable to the 2016 and subsequent taxation years allow more flexibility in claiming the donations, but only if either:

(a) the gift is made no more than 36 months after the taxpayer's death by the taxpayer's GRE, or

(b) the gift is made more than 36 months, but no more than 60 months, after the taxpayer's death by the taxpayer's former GRE (i.e., where the taxpayer's estate ceases to be the taxpayer's GRE because it remains in existence for more than 36 months after the taxpayer's death and, at the time the gift is made by the estate, the estate continues to meet the other requirements set out in the GRE definition to be the taxpayer's GRE).

In all other cases, the normal rules apply in that the charitable donation credit may be claimed by the trust in the year of the gift or the following five years.

Under the new rules, for deaths after 2015, charitable donations made by will and by the estate are all deemed to have been made by the estate, at the time the property is transferred to the charity. Pursuant to paragraph (c) of the definition of "total charitable gifts" in subsections 118.1(1) and (5.1) of the ITA, if a gift is made by a 60-month estate of property acquired by the estate as a consequence of the death of an individual, the estate will have the flexibility to allocate the donation to any of:

- the estate's taxation year in which the donation is made or any of the five following taxation years of the estate;
- any preceding year of the estate in which it is the individual's graduated rate estate; or
- the last 2 taxation years of the deceased individual.

The donation credit that may be claimed on the deceased's return for the year of death or the immediately preceding year is not subject to the 75% limitation on net income.

4. CHARITABLE GIFTS AND ALTER EGO/JOINT PARTNER TRUSTS – RULES AND TRAPS

Notwithstanding that alter ego and joint partner trusts are viewed as "will substitutes", there are some significant differences between making charitable gifts in wills and in these trusts. The following is a discussion of the rules applicable to alter ego and joint partner trusts in making charitable gifts as well as some special issues to consider when making charitable gifts in alter ego and joint partner trusts.

(a) RESTRICTION ON GIFTS DURING THE LIFETIME OF THE SETTLOR (OR THE SETTLOR'S SPOUSE)

As discussed above, while the settlor of an alter ego trust is alive, the settlor is the only person who can benefit from the income and capital of the trust. In the case of a joint partner trust, only the settlor and the settlor's spouse can benefit from the income and capital of the trust until the death of the survivor. As a result, the trust is not able to make any charitable gifts before the death of the relevant life tenant. This can be important as often the majority of a person's assets are transferred to the trust and it is from that pool of assets that a gift would usually be made.

One strategy to circumvent this restriction is to have the trustee distribute trust property to the relevant life tenant who could, in turn, make the charitable gift in his or her personal capacity. This may achieve the settlor's (or the settlor's spouse's) philanthropic intent, but as discussed in (b) below, it is important to avoid a mismatch where the donation tax credit is available to the relevant life tenant, but the taxable income against which it could be used arises in the trust. Since subsection 75(2) of the ITA typically applies to these trusts to attribute the trust's income to the settlor, this is often not a problem.

(b) MISMATCH OF TAX LIABILITY AND DONATION TAX CREDIT

The relevant life tenant and the alter ego or joint partner trust are separate taxpayers and file separate income tax returns. This is an important fact to remember when considering which property to transfer to an alter ego or joint partner trust. In an ideal world, the goal is to ensure that on the death of the relevant life tenant the property with accrued capital gains and the property with capital losses are held by the same taxpayer so that they can offset each other. If this fact is overlooked, a situation may result where the settlor has significant capital losses on the property forming part of the settlor's estate on death or loss carry-forwards but the alter ego trust has significant capital gains. The losses in the settlor's hands cannot be used to offset the gains arising in the trust or vice versa.

A similar problem arises with charitable donations. Estate planners need to be careful to ensure that the donation tax credit will match the taxpayer who has the tax liability on death. For example, if an individual makes a charitable donation through his or her will, but the majority of his or her assets are held in an alter ego trust, on the individual's death there will be a deemed disposition of the property in his or her name as well as a deemed disposition of the property in the alter ego trust. If the deemed disposition in the trust gives rise to significant capital gains, the donation tax credit from the gift made in the individual's will cannot be used to offset the capital gain in the trust. Thus, it is important to consider not only what property is contributed to the trust and what remains in the individual's estate but also to consider whether is it most efficient to make a charitable donation through the individual's will or through the alter ego trust.

(c) NO CARRY BACK

As discussed above, when a donation is made in a will, if the donation exceeds the available limit for the terminal taxation year, the unused portion of the donation tax credit can be carried back to offset tax arising in the year preceding death if the more flexible rules apply. However, when a donation is made through an alter ego or joint partner trust, there is no ability to carry back any excess donation tax credit. The donation tax credit must be used by the trust in the year of the death of the relevant life tenant or in the following five years.

(d) TIMING ISSUES

The year-end for all *inter vivos* trusts is December 31. The filing deadline for a trust's income tax return is 90 days after its year-end (i.e. the end of March each year). When a charitable gift is made in an alter ego or joint partner trust, the donation receipt is only issued when the gift is actually completed.

When the relevant life tenant dies, the alter ego or joint partner trust has a deemed year-end at the end of the day on which the death occurs pursuant to subsection 104(13.4) of the ITA. In the situation where the alter ego or joint partner trust realizes a capital gain at that time pursuant to subsection 104(4) of the ITA, clause (c)(ii)(C) of the definition of "total charitable gifts" in subsection 118.1(1) of the ITA allows for the inclusion, in the alter ego or joint partner trust's total charitable gifts, of a gift made by the trust in a shortened taxation year as a result of a deemed year-end triggered by paragraph 104(13.4)(a) of the ITA, if:

(a) the gift is made on or before 90 days after the end of the calendar year in which the relevant life tenant dies[13]; and

(b) the gift is property held by the trust at the time of death or property that was substituted for that property.

Thus, it is important to time the gift so that the donation tax credit can be used to effectively offset income tax payable by the trust. As the deemed disposition of the trust property on the death of the relevant life tenant often gives rise to a tax liability, the donation must be made on or before 90 days after the end of the calendar year in which he or she dies in order to permit the donation tax credit to be used to offset the resulting tax liability. Where the relevant life tenant dies early in the year, there will usually be sufficient time to complete the gift. However, if the relevant life tenant dies late in the year, the trustees of the trust will need to complete the gift quickly in order

[13] *Supra.* Note 8.

to use the donation tax credit. If the gift is not completed before end of March of the next year, although the donation tax credit in the trust can be used to offset tax in the trust in the five years following, often there is either very little tax for the trust to pay on an ongoing basis or more commonly, the trust is wound up shortly after the death of the relevant individual and the utility of the donation tax credit is lost.

(e) CHARITABLE REMAINDER TRUSTS

A charitable remainder trust is structured to secure an immediate charitable receipt for a deferred gift to charity. While the property is held in the trust, the income generated by the property can be enjoyed on an ongoing basis by the settlor or by any other income beneficiaries designated in the trust agreement. The terms of the trust have to unconditionally and irrevocably direct that the capital will be paid to a charity or other qualified donee when a future event occurs. The settlement of property into the trust on those terms creates an equitable interest in the trust that belongs to the charity. Since the gift of the equitable interest is considered to be immediate, the charity can issue a charitable receipt for the value of that equitable interest at the time the property is settled into the trust. A charitable remainder trust, once in place, is taxed like any other kind of trust.

With a properly drafted charitable remainder trust, the individual receives the tax benefit of having made the gift immediately while retaining the use of the property donated until some future date. The CRA's position is as follows:

> Where the property donated consists of a residual interest in real property or an equitable interest in a trust, the Department will consider a gift to have been made if all of the requirements listed below are met:
>
> (a) There must be a transfer of property voluntarily given with no expectation of right, privilege, material benefit or advantage to the donor or a person designated by the donor.
>
> (b) The property must vest with the recipient organization at the time of the transfer. A gift is vested if:
>
> - the person or persons entitled to the gift are in existence and are ascertained,

- the size of the beneficiary's interests are ascertained, and
- any conditions attached to the gift are satisfied.

(c) The transfer must be irrevocable.

(d) It must be evident that the recipient organization will eventually receive full ownership and possession of the property transferred.

Once it is established that a gift has been made, the value of the gift at the time of the transfer must be determined before it can be claimed for income tax purposes.[14]

Thus, before a gift via charitable remainder trust will be considered to have been made, there must be a transfer of property appropriate for the type of property involved to the charity. In addition, the transfer must be irrevocable and the charity must eventually receive the entire property.

One difficulty with charitable remainder trusts is the valuation of the gift because it is the remainder interest which must be valued. Where the valuation of the remainder interest given to the charity is not capable of valuation, CRA will deny the receipt received.[15] The method of valuing a gift will vary depending upon the type of gift made, the age and health of the donor and other factors. Generally, the CRA's approach is to value the various interests taking into consideration the fair market value of the property itself, the current interest rate, the life expectancy of any life tenant, and any other factors relevant to the specific case.[16] Those factors have been stated as including the type of gift, other interests in the property or the trust, and the documentation providing for the gift.[17]

It is possible to draft an alter ego or joint partner trust in which the settlor (and the settlor's spouse in the case of a joint partner trust) is entitled to the income of the trust but is not entitled to any capital. In these circumstances, if a charity is named as the residual beneficiary of the capital of the trust after the death of the settlor (or the settlor's spouse in the case of a joint partner trust), the amount of the gift is ascertainable and capable of being valued and the settlor will likely be viewed

[14] Interpretation Bulletin IT-226R [archived], "Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust" (November 29, 1991).
[15] *Ibid.*
[16] *Ibid.*
[17] *Ibid.*

as having made the gift at the time he or she transfers the gifted property to the trust. The charitable donation, for donation tax purposes, is the net present value of the remainder interest in the trust.

The CRA has expressed the view that a trust can simultaneously qualify as both an alter ego trust and a charitable remainder trust.[18] In stating that view, the CRA took the position that the current value ascribed to the charitable remainder would have to be adjusted downward to a lower amount to take into account the capital gains taxes that are eventually payable by an alter ego trust on the deemed realization triggered by the death of the settlor-lifetime beneficiary.

Since section 75(2) of the ITA applies to alter ego and joint partner trusts so that income and capital gains and losses will be attributed to the settlor during his or her lifetime, in the first five years of the trust, this donation tax credit may assist the settlor in offsetting tax payable on income that is attributed back to him or her from the trust. Whether this is significant will depend on the income of the settlor. Unfortunately, this donation tax credit cannot be used to offset the more significant tax liability that arises on the death of the settlor (in the case of an alter ego trust) or the survivor of the settlor and the settlor's spouse (in the case of a joint partner trust). For this reason, establishing charitable remainder trusts in alter ego and joint partner trusts is of limited utility from a tax-saving perspective. However, a settlor could possibly elect to trigger a gain on property transferred to such a trust and use the donation receipt to offset the gain this would increase the cost base of the property in the trust and reduce the taxable gain on death.

(f) RESTRICTIONS ON GIFTS TO A PRIVATE FOUNDATION

It is not uncommon that an individual proposes to gift shares of or debts owing from a private company controlled by the individual to a non-arm's length private foundation upon his or her death. If such shares or debts have been transferred to the individual's alter ego or joint partner trust during his or her lifetime, there are two issues that must be considered.

(i) NON-QUALIFYING SECURITIES RULES

As discussed above, if the trust gifts non-qualifying securities to a private foundation with which it does not deal at arm's length (for example, where both the trustees of the trust, the directors of

[18] CALU 2010 Roundtable 2010-0359461C6, "Question 7: Alter Ego Trust as Charitable Remainder Trust" (May 4, 2010).

the private company and the directors of the private foundation are the same group of individuals, i.e. the settlor's children, the private foundation cannot issue any donation receipt to the trust until the non-qualifying securities cease to be non-qualifying within 60 months of the donation or the private foundation disposes of the securities within 60 months for consideration that is not anyone's non-qualifying security. Accordingly, if none of the events occurs on or before 90 days after the end of the calendar year in which the relevant life tenant dies, this donation tax credit cannot be used to offset the tax liability that arises on the death of the relevant life tenant.

(ii) EXCESS CORPORATE HOLDINGS REGIME

The excess corporate holdings regime places limits on a private foundation's share ownership that also takes into account the holdings of any relevant person (defined in subsection 149.1(1) of the ITA to generally mean a person not dealing at arm's length with the foundation). Generally, where the charitable gifts are not shares, the excess corporate holdings are not applicable. The regime generally limits a private foundation's share ownership to 20% of the shares of a particular class. In determining the percentage of shares held, shares held by relevant persons are also taken into account. Generally, the rules do not apply where a foundation holds less than 2% of all the issued and outstanding shares of a class.

The excess corporate holdings regime imposes two obligations on a private foundation if it, taking into account the holdings of any relevant person, holds more than 2% of any class of shares of a corporation (including both publicly traded securities and private company shares):

(a) The monitoring obligation. If the foundation's total corporate holdings percentage of any class of shares of a corporation exceeded 2% of the issued and outstanding shares of that class at any time during its fiscal period, the foundation has to determine and report to the CRA the percentage of shares that it and any relevant persons with material interests held, at the end of that fiscal period, of each class of shares of the corporation. It must also report its own material transactions and the material transactions of any relevant persons for each such class of shares.

(b) The divestment obligation. If the foundation holds more than 2% of a share class of a corporation at the end of its fiscal period, and the foundation and all relevant

> persons together hold more than 20% of that same class of shares, the foundation may be subject to divestment obligations, which means the foundation must reduce its excess corporate holdings percentage within specified periods. Each year, a private foundation determines its divestment obligations by appropriately allocating its net increase or net decrease in its excess corporate holdings percentage.

Where an alter ego or joint partner trust gifts private company shares to a private foundation and the trust, the company and the foundation are not dealing with each other at arm's length, consideration must be given to the excess corporate holdings regime.

5. CONCLUSION

What is clear from the above is that with careful planning, a charitable gift can be made to work both for the charity and the donor, and a careful estate planner dealing with a client who prefers trusts, in particular, an alter ego or joint partner trust over a will in making such gift and has some charitable aspirations will explore the various options available and tax benefits. In choosing the appropriate donee, gift and method of gift, planners must be aware of the goals of the client, the type of property available for donation and the client's tax status apart from the gift. Charitable vehicles can go a long way to reducing the total tax payable by an individual either immediately or upon their death, but the most appropriate goals must be chosen and the most efficient vehicle with the most appropriate subject matter must be used to reach those goals.