**Strategic Giving: Where Technique and Product Knowledge Results in Transformational Giving While Benefiting Canadian Donors and Their Families**

# Strategic Planning
# Session 1
# Knowing the Donor

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## INTRODUCTION

**Dear Friend,**

This Handbook, first published in 1997, is now in its second edition. While it has been continually edited to reflect changes in the law, this new edition attempts to change some of the essence of the material.

Planned Giving is often seen as a set of products – annuities, bequests, insurance, etc. – and the first edition examined planned giving product by product.

Planned Giving: the meaning is varied. To some organizations it means bequests. But the words are simple: gift planning, or gifts that are planned. Planning is not a product, but a process. It may end with a product – or it may not. In its essence, planned giving is an interaction between the needs of the donee, the needs of the donor, and financial mechanisms, hopefully creating a result that is as effective as possible.

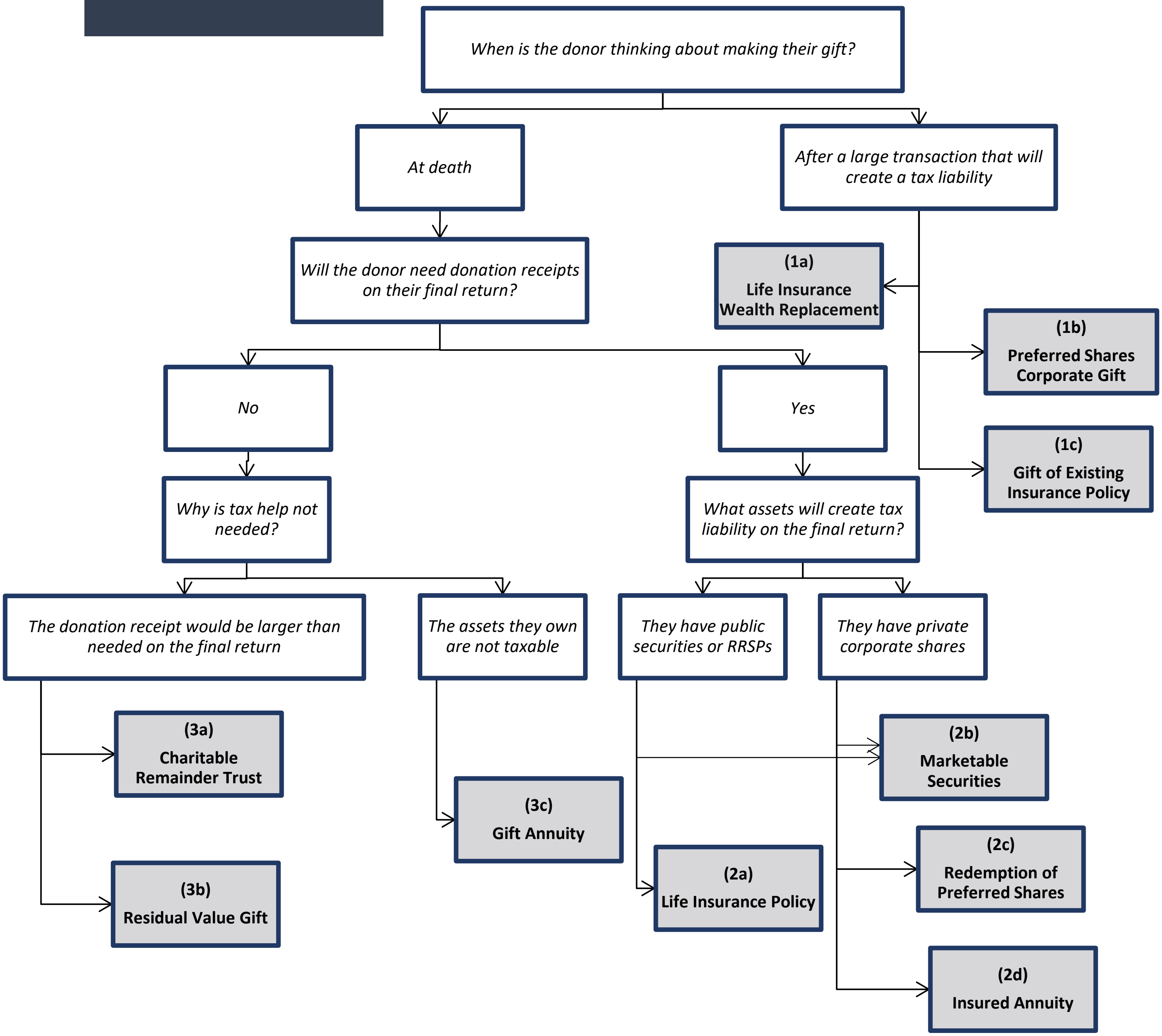
This edition makes a few changes which are intended to help understand the process. We (with my collaborator, Dr. Carolyn Tobin) set out in the first chapter a decision tree which matches the needs of the donor with possible outcomes or products. Each product chapter contains new information suggesting who the product is best suited to. The last chapter now introduces a philanthropic review for a fictional family. It considers a process for this family that reveals their best possibilities for planned giving.

The objective of the first edition was to allow fundraisers and professionals to stimulate more charity and good deeds. We hope this edition does the same!

**The information contained in this Handbook reflects tax law in effect as of May 2021**

## 1. A Personal Approach

**Working in planned giving** is ultimately about building connections with people, not strategy or product. There are three broad categories of potential donors covered in the following pages: donors hoping to give following a large transaction, donors hoping to offset their taxes due at death through philanthropy, and donors who will not need any tax help at death. Consider the following decision tree:



### Scenario 1: After a Large Transaction

First, imagine a donor who foresees a large transaction in their future. If the transaction will create a large amount of tax liability, it presents an excellent opportunity to use a donation receipt. There are three main plans for this kind of donor. The first plan **(1a)** is a life insurance wealth replacement. In this plan, the donor donates to create tax savings, then purchases a life insurance policy to replace the amount of wealth that they just donated. See Section 14, page 31 for more details. The second plan **(1b)** is a corporate gift of preferred shares. In this scenario, the donor gifts dividend-paying preferred shares to a charitable organization. They obtain a large charitable receipt to help offset the taxes due on their transaction, while dividend refunds allow them to regain a significant amount of cash. See Section 11, page 24 for more details. The third plan **(1c)** is the gift of an existing insurance policy. In this scenario, if the donor has an old insurance policy that they no longer need, they can gift it to charity and receive a large receipt. See Section 5, page 14 for more details.

### Scenario 2: Reducing Taxes at Death

Consider a donor who hopes to use a charitable receipt to minimize his taxes owed at death. If they hold public securities and/or RRSPs, there are two plans available to them. In the first plan **(2a)**, they can purchase a life insurance policy to benefit the Charity allowing for the yearly premium payment to be tax deductible. See Section 5, page 14 for more details. The second plan **(2b)** involves marketable securities. In short, gifts of appreciable securities are extremely tax effective, even if given in a will, because they avoid the capital gains tax. See Section 10, page 23 for details.

If the donor doesn't have many public securities/RRSPs but instead holds a significant stake in a private corporation, though they will also see a large capital gain on the final return, they have different giving options. Gifts of marketable securities **(2b)** are also a viable plan, though their application is slightly different. See Section 10, page 23 for more details. The second option available is the redemption of preferred shares **(2c)**. This plan involves gifting preferred company shares to a charitable organization. Normally these shares would be taxable at death, so gifting the shares creates immediate tax savings along with a dividend refund upon redemption. See Section 11, page 24 for more details. Finally, donors can opt for an insured annuity **(2d)**. In this plan, the donor replaces their assets with an annuity to live on and an insurance plan, which is not taxable at death; this therefore eliminates taxes owed upon death. See Section 4, page 13 for the fundamentals of the plan and Section 15, page 32 for more details on this specific implementation.

### Scenario 3: No Tax Help Needed

This donor is not looking to reduce the taxes owed on their final return. If this is because their donation receipt will be larger than the income created at death on their final return, there are two ideal options. First is establishing a charitable remainder trust **(3a)**. This plan creates a donation receipt that can be used immediately, but dollars are still transferred at death. See Section 7, page 17 for more details.

The second option is a residual value gift **(3b)**. In this plan, the donor donates an asset, such as a personal residence, to a charity, but continues to use it for life. They obtain an immediate tax receipt, but again the gift is physically given at death. See Section 8, page 19 for more details. If the donor simply owns assets that are not taxable, their best option is a gift annuity **(3c)**. In short, the gift annuity replaces a fixed income investment, which insures a more tax-effective life return. See Section 4, page 13 for more details.

## 2. The Basics: Percentage Limitations and Excess Contributions

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

For individuals, the system works on a credit system. Federal tax credits are applied on three levels. For the first $200 of donations made a credit of 17% is available. Thereafter the credit is 29%. As 29% is also the top Federal marginal tax rate, donations can effectively be used to reduce income taxes payable at the same rate that income is taxed with the new surtax of 4% for an income over $200,000 as corresponding charts tax credit is given. Provincial tax, except for Quebec, is a function of Federal Tax. Thus, a donation tax credit reducing Federal tax will automatically reduce provincial tax. In this handbook, for illustrative purposes, we assume that donations are made over the $200 threshold and therefore saving tax at the highest rate. On a combined Federal and provincial level, if the top marginal rate for an Ontario resident is 46% or 50%, then the effective tax saving for a dollar of donation is 46 cents or 50 cents.

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

### Percentage limitations

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

How much a donor may deduct as a charitable contribution in any year is determined by the application of the percentage limitation to the donor's contribution base, effectively, the net income of the taxpayer.

Net income is made up of normal income items of the taxpayer, such as salary, taxable dividends, rental income, taxable capital gains, business income, etc., less certain deductions including RRSP, RPP, child care deductions, investment expense deductions, as well as most tax shelter deductions.

A donor may be limited in the amount which can be deducted in any given year based on net income. These limitations are as follows:

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

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

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

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

(e) Gifts of Canadian Cultural or Ecological projects can be applied against 100% of income.

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

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

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

In a shareholder/manager situation one can maximize the donation base by studying both the corporation and the individual. Put another way, if the corporation is having difficulty utilizing its donations the individual could start making donations. To fund the individual making the donation, the company could pay salary or dividends to that individual which would be deductible to the corporation and the donation would effectively be used to shelter the income in the individual’s hands. If an individual is having trouble utilizing his/her donations, the corporation can be used to make the donation and use up its percentage limit.

The Income Tax Act allows spouses to share their donations. Thus, if one spouse is limited in the use of donations due to the base limit, the other spouse can claim the donations on his/her tax return.

### Corporations

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

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

### Carryovers

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

***EXAMPLE 2***

*Holdco owns 100% of OPCO. Both companies are Canadian-controlled private corporations. Holdco has net income of $1,000,000 in the year and has made a $1,000,000 gift to Charity It appears that the donation will be deductible in the year to the extent of 75 percent of net income or $750,000. Holdco causes OPCO to declare and pay a $333,333 dividend. Holdco retains the cash or reinvests in OPCO via shares or loan. Holdco's tax return is evidenced as follows:*

***Calculation of net income***

| | |
|---|---|
| As before | $1,000,000 |
| Taxable dividends received | 333,333 |
| | $1,333,333 |

***Adjustments in arriving at taxable Income***

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

***In the end, the full receipt is used in the year.***

## 3. Bequests

**Bequests remain the number one method** for charities to receive major gifts.

There are many forms of bequests to charities contained in a will, the most basic being a specific bequest, such as the outright gift of a certain amount of money or a particular property or income source. Some testators will leave a percentage of the estate to a charity, for example, 20% of the estate to the charity.

In some cases, the amount given to a charity is a residual bequest after other specific bequests have taken place, i.e., leaving a set sum of money to some relatives with the balance of the estate given to a charity or a group of charities. Finally, you may also see donors making contingent bequests, where the gift to a charity is dependent on the occurrence of another event. For example, the donor may make a bequest to Charity only if the original beneficiary predeceases him/her.

### Planning Tip:

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

***WHO SHOULD USE THEM?***

*Bequests are an easy, tax-effective, and scalable type of gift that can be useful to any donor. Capable of incorporating gifts of RRSPs and life insurance, bequests can be funded for donors with corporate estate issues through the purchase of company owned insurance policies. Bequests should be made with appreciable marketable securities.*

*Possible alternatives: gift annuities or charitable remainder trusts.*

## Sample Will Clauses

**Unrestricted Bequest**

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

*I bequeath to Charity the sum of $ _ to form part of its permanent endowment. The gift should be made, to the extent possible, from appreciated securities."*

**Bequest with Specific Income Direction**

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

*I bequeath to Charity the sum of $ _ to form part of its permanent endowment. The income generated by this bequest is to be used for (state the purposes for which the income is to be used.) If, in the opinion of the Trustees of Charity, the need for funds for the purposes designated no longer exists, the income may be used for the general purposes of Charity. The gift should be made, to the extent possible, from marketable securities."*

**Unrestricted Memorial Fund Bequest**

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

*I bequeath to Charity the sum of $ to form part of its permanent endowment and to be designated as the (name) Memorial Trust Fund. The income generated by such fund is to be used for the general purposes of Charity. The gift should be made, to the extent possible, from appreciated securities.*

**Memorial Fund Bequest with Specific Income Direction**

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

*I bequeath to Charity the sum of $ to form part of its permanent endowment and to be designated as the (name placed here) Memorial Trust Fund. The income generated by such funds is to be used for the (state the purposes for which the income is to be used). If, in the opinion of the Trustees of Charity the need for funds for the purposes described no longer exists, the income may be used for the general purposes of the Charity. The gift should be made, to the extent possible, from appreciated securities.*

**Residual Bequest**

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

> *I bequeath to Charity 10% of the residue of my estate after payment to the particular beneficiaries. The gift should be made, to the extent possible, from appreciated securities.*

**Trust**

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

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

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

Unfortunately, the provision above is no longer tax effective. The reason for this is that CRA considers the payment to the Charity after the death of the second spouse to be a distribution by the trust and not a donation. Why? As the payment to the charity is not a choice of the trust, but a direction, then the taxpayer (the trust, not spouse 1 or spouse 2) has no charitable intent and thus is not donating. Weird interpretation but quite onerous tax-wise.

Consider spouse 1 ("S1") who owns appreciated property, say shares of a holding company. S1 leaves a bequest of the shares to a trust, the beneficiary for lifetime is spouse 2 ("S2"). The capital beneficiaries at S2's death are children to the extent of 50% and Charity for the other 50%.

This is a spouse trust and when S1 passes away there is a tax rollover into the trust. When S2 passes then the property within the trust is deemed to be disposed of and a capital gain is realized BY THE TRUST, NOT SPOUSE 2. The trust distributes 50% of the property to the Charity, expecting the resulting donation receipt to be applied, in the trust, against the taxable capital gain. But not according to CRA.

The solution is to write the will bequest in a different manner. The spouse trust is created but instead of setting out a distribution to Charity, the testator will set out a direction allowing the trustees, after the death of S2, at their complete discretion, to make donations to Canadian charities to a maximum of 50% of the property. This makes the donations discretionary, which means the trustees , not spouse 1, exercises charitable intent. The payment to the Charity is tax deductible but note this is on the trust return which is allowed to use donations to the extent of 75% of income, not 100% as on a final return.

Spouse 1 would prepare a letter to the trustees explaining the provision in the will but also indicating that S1 would want the trustees to make the donation of 50% to Charity (a specific charity).

There are many wills in Canada which contain the former provision and these wills should be changed.

If in the above trust the spouse cannot encroach on capital, this trust is in effect a charitable remainder trust. Unfortunately, this trust will not yield a donation receipt for the final return if in the will.

### Who has Made the Gift - Will or Estate?

Given the 100% income limit on death, a will gift creates interesting planning possibilities. The taxation of will gifts has changed as of deaths occurring after December 31, 2015. Gifts will be made by the estate, and not deemed to have been made by the deceased. The date of the donation and the value and consequently the charitable receipt will be based on the date of transfer of the property to the charity. If the estate is a Graduated Rate Estate (which has a three-year life after death), the estate can use the receipt in its tax return or can designate the use in the deceased' final tax return and/or the year preceding the year of death. The benefits of giving listed securities, Canadian Cultural Property or Ecological Property will transfer to the final return. Thus, the capital gains exemptions on these gifts will be utilized on the final return. Thus, there are two separate valuations for property gifted in a will. First the deemed disposition at death of the property, based on the value at death. Second, if the property is transferred to a charity within three years of death, the actual date of transfer will be the date the gift valuation is done.

### Graduated rate estates

Our current tax laws set out that the trust created at death to be the one to have made the donation pursuant to a will. The donation must be paid to the charity to be recognized as a gift. This graduated rate estate ("GRE") may elect in its tax return to have the gift to be utilized in its final tax return rather than the estate (trust) itself. So we need GRE status, but effectively we choose when we want.

Do we wish the tax credit to be used in the trust (perhaps because of a 164 (6) transaction) or in the final tax return to apply against deemed dispositions or RRSP income at death? If in the final return then one should ensure that the GRE pays the donation and then elects in its return. The payment is a new requirement- previously final tax returns claimed donation credits upon filing, even when the donations were to be paid in the future.

### *Consider the following:*

John passes away on August 1, 2017. On death, the trust is created which is a GRE. His assets include $1 million of RRIFs and he has made in his will a $2 million gift to charity "A". We will file the final return on April 30, 2018 including $1 million of RRIF income but likes to include in the return at least a $1 million of donation receipt of Charity A so as not to pay tax on the RRIF income. So the trust pays out to charity "A" $1 million on March 28 2018 and sets out a March 31, 2018 year-end for the trust. It elects in its trust tax return to move the donation to the final return. Thus, when we file on April 30th we will utilize the $1 million receipt in that tax return to eliminate the tax. Of course, if one paid the donation in say August 2018, the final return would have been filed evidencing an income tax liability. After the year-end of the trust, where the election would have been made, a filling would be due to amend the final tax return to remove the tax that was owing. Also note that it is not necessary for the testator to identify the institutions particularly in the will. The executors can decide where the donations are made after death.

***EXAMPLE***

*Mr. Goldman wishes to leave a $1,000,0000 bequest to Charity for the purpose of building a center in the name of himself and his late wife.*

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

*On death the $1,000,000 gift, via his will, paid by the Estate or elected by the Estate, will be used to offset the tax on the $300,000 of taxable income in Mr. Goldman's final tax return and the $100,000 taxable income in the preceding year's return.*

*It is suggested that Mr. Goldman leave, via his will, $400,000 to Charity which can act to shelter the income described above. The balance of the gift should be left to his three children. Mr. Goldman, Charity, and the three children should enter into a pledge agreement setting out the three children to gift $600,000 to Charity upon receipt of these funds from the estate.*

*The children will each receive a $200,000 charitable donation receipt which they can use to shelter income from tax in the year of gift or in the five subsequent years. $300,000 of additional tax savings will be realized.*

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

## 4. Charitable Gift Annuities

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

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

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

***WHO SHOULD USE THEM?***

*Charitable gift annuities are perfect for an elderly donor earning fixed income style returns. They represent a way to increase the donor's yield tax-effectively while supporting an organization. They are also useful for donors who plan to give most of their estate to charity. These annuities also yield an immediate tax receipt while maintaining an income flow.*

The CRA position on gift...plus annuity is strictly administrative. Its bulletin on the issue IT-IIIR2 has been withdrawn. The new policy is best described via an example:

***EXAMPLE: The donor transfers $100,000 to a charity.***

| | |
|---|---|
| Life expectancy | 10 years |
| Annual annuity | $8,000 |
| Cost of the annuity | $50,000 |
| **Tax results** | |
| Receipt issued | $50,000 |
| *(Amount transferred $100,000* | *less cost- $50,000)* |

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