CAGP

UPDATE: Estate Donations

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Since the concept of the "estate donation" was introduced in the 2014 Federal Budget it has been a source of mixed feelings among the planning community, but general enthusiasm in the charitable sector. The estate donation rules apply to gifts by will (bequests) to qualified donees, as well as direct designation gifts, such as life insurance, RRSPs, RRIFs and TFSAs. As of January 1, 2016, the rules became law for any new deaths. And 15 days after the New Year amendments were released making some welcome improvements. This article reviews the rules and addresses the recent changes and what still needs to be done.

Background

The "estate donation" was introduced simultaneously with new rules for *inter vivos* and testamentary trusts, as well as the new Graduated Rate Estate (GRE) that now exists for the first 36-month after a taxpayer dies. Prior to 2016, gifts by will to charity were legally *deemed* to occur just before the date of death making the gift by the deceased, not the estate. To be clear, the gift was considered be a lifetime gift for tax purposes. Any gift by will could be carried back to be claimed against 100% of net income in the final two lifetime taxation years, but not forward to be claimed against income in the estate. Moreover, the date and value of the gift was deemed to be date of death, not the time property was received by the charity.

The estate donation changes the timing of the gift and the claim period. As the name states, a gift by will is now a gift of the "estate", which is a different taxpayer than the deceased individual. The claim period was increased from two years to *up to* five years: the GRE taxation year in which the gift was made, any earlier taxation year of the GRE (at 75% claim limit), and the final two lifetime tax returns (at 100% claim limit). The extra claim period potentially provides taxpayers who make gifts that are large relative to income with more tax relief, as there is more income to claim it against.

As initially drafted, however, the rules stipulated that the gift must be received by the charity/ies within the 36-month GRE period in order to be able to claim against income in the five eligible tax years. The extra claim period could provide additional tax benefits for estates with large gifts to charity (i.e. residual bequests), but those tax savings would be largely lost if the property is received after the 36-month GRE. An estate with illiquid property (art, private shares, real estate) could lose tax savings if the estate is unable to sell and distribute within the GRE period. Similarly, estates undergoing litigation could lose tax benefit due to delayed distributions. Or the charity may be dealing with a tardy and inexperienced estate trustee. In all cases the gift may be reduced and the charity disadvantaged.

One benefit of the rules to charities is that they simplify tax receipting. Charities now clearly receipt the gift based on the fair market value on date of receipt. While this was common practice under the old rules, technically the gift value was established at date of death. A number of sessions at recent CAGP conferences expressed concern about the risk of false receipting that charities previously faced. This concern is now behind us.

January 15th Amendments

On January 15th, 2016 the Department of Finance announced two helpful changes to the recently implemented rules and backdated them to the beginning of the year.

1. The period for transferring the donation to charity has been extended from 36 to 60 months after death. The claim period is the final two lifetime returns and the estate year in which the gift was received for the period after the 36-month GRE.
2. The rules have been clarified to ensure that donations of property exempt from capital gain during life – ie public securities, cultural property gifts and eco-gifts – will be exempt for estate donations. These rules assume that the property is owned by the individual prior to death. Capital gain exemptions in year of death also apply to the extended claim period.

The 60-month transfer period provides enough time for the vast majority of estates to transfer the property to charity and claim maximum tax benefit. The claim period is slightly reduced for those gifts received after the initial 36 months, but in most situations involving illiquid assets or litigation there should be an alignment of liability and credit/deduction. The extra 24-month period will be less forgiving to estate trustees who are late distributing assets or have not timed liabilities and credits. The extension will help ensure charities do not see reduced gifts due to increased tax bill.

Pursuing this extension was a major focus of the CAGP Government Relations Committee. We are grateful to officials at the Department of Finance for their engagement and their willingness to make changes to ensure charities and donors are treated fairly. These are complex rules and it is positive to see a commitment by all parties to ensure they retain existing principles.

The other change relating to donations in the January 15th amendments relates to gifts from trusts, presumably made at the discretion of the Trustee as opposed to mandated by the settlor. A tax receipt may be issued for a donation made by the trust within 90 days after the end of the calendar year in which the primary beneficiary dies. This enables the donation to be claimed in the taxation final year of the trust.

Outstanding Issues

There are at least two outstanding issues arising from new rules that CAGP is still pursuing.

1. **Private Company Shares Donations:** All estate donations of private company shares to a public charity – charitable organization or public foundation – will now be considered to be Non-Qualifying Securities (NQS). Under the previous rules a dead donor was considered be an arm's length donor. Under the new rules the securities are NQS and no receipt may be issued until they

are sold. The reason for this strange outcome is that the donor is the estate, not the deceased. An estate is a trust and the beneficiaries of trusts are not at arm's length from the trust. Therefore, all estate donations of private company shares are NQS. This is an unintended consequence that CAGP is hopeful will be addressed in the next round of amendments.

2. **Charitable Remainder Trusts:** The tax treatment of testamentary charitable remainder trusts (CRTs), which includes spousal trusts with charitable remainder beneficiaries, is now unclear. Prior to 2016, there were two types of testamentary CRTs:
    a. CRT eligible for a receipt at death and did not permit encroachment of the trust capital. The tax receipt could be issued for present value of the remainder interest and claimed against the final two lifetime returns. Arguably this CRT would fit into the estate donation rules, but the timing of CRT establishment is now unclear.
    b. CRT ineligible for a tax receipt at death because there is encroachment of capital and ineligible at time of distribution because it is a gift by will from the testator. (A receipt could be issued at distribution if the trustee has discretion to make the gift, but this rarely occurred.) This second type of testamentary CRT is the more common variant. With the introduction of estate donation, however, the estate, a trust, is the donor. So, would it not make sense for CRTs that allow capital encroachment to receive and claim a tax receipt at time of capital distribution? CAGP is exploring this option through submissions to the Department of Finance.

The January 15th amendments have helped improve estate donations and the new trust rules. There is still work to be done, but it is encouraging that the consultation process with the Department of Finance has yielded results. The first few years of the estate donation rules will help clarify how they work in practice, but at this point the new regime is positive for the majority of donors and charities. Charities have also received a gift to help them promote estate donations. This is a once in a generation change and it provides an excellent opportunity to contact and educate donors. Estates should be reviewed and, in certain situations, plans updated. Change is an opportunity for dialogue and, out of dialogue new gifts will arise.

Malcolm Burrows is Head, Philanthropic Advisory Services at Scotiatrust and the founder of Aqueduct Foundation, a public foundation with donor advised funds. He has been a gift planner for 25 years and is a Friend of CAGP since 2003.