Charitable Gifts at Death

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(i) Summary

Charitable remainder trusts are not recognized under the Income Tax Act (the "Act") as a separate type of trust for income tax purposes, but are in widespread use as tax planning vehicles for individuals who wish to make charitable gifts.

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 instrument. 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. The purpose for using a charitable remainder trust is to provide the settlor with a mechanism to make a gift to charity, while incorporating a favourable tax result for the settlor.

The capital beneficiary must be a registered charity or other qualified donee, and must be specifically and expressly designated in the trust document at the outset. The settlement of property into the trust must qualify as a gift, and cannot be made out of obligation or with expectation of reward. It must be possible to value the equitable interest that is created. The value of the gift is determined by asking how much capital would have to be set aside on the date when the property is initially settled into the trust, in order to produce a sum of money equal to the fair market value of that property on the projected date on which the property will in fact be transferred to the charity. Thus, the charitable receipt will not be for the full fair market value of the property on the date that the property is settled into the trust. The longer the charity has to wait for the money, the smaller the immediate benefit of the gift to the charity and the smaller the charitable receipt.

Care should be taken in selecting the type of property to be settled into the trust as transfers of movables, like artwork, or shares in closely held private corporations, can result in unanticipated tax consequences. The settlor, while entitled to a charitable receipt, will have to deal with any capital gains or losses triggered by the disposition. A charitable remainder trust can be testamentary or *inter vivos*.

CRA has said that this type of trust is under review. Based on currently published commentary, care should be taken if the terms of trust involve multiple settlors, multiple income beneficiaries, multiple charities, multiple contributions into the trust, or gifts creating income rather than a capital interest for the charity.

(ii) General Comments Relating to Charitable Remainder Trusts

(A) Origins and Conceptual Background

Charitable remainder trusts are not recognized under the Act as a separate type of trust for income tax purposes. A trust is said to be a charitable remainder trust when the settlor is entitled to claim the appropriate charitable deduction or tax credit at the time capital is settled into the trust, the trust itself is not a registered charity or other qualified donee, and the settlor is entitled to that tax relief notwithstanding that the charity or other qualified donee will not receive any capital until some deferred time in the future. The trust, after it is in place, is treated and taxed like any other trust. It is the settlor's tax treatment that is at issue.

CRA prefers to deal with this area of tax law by reference to a gift to a charity of an equitable interest in a trust, but it has become common parlance to refer to "charitable remainder trusts" and that terminology has been adopted here.

While gifts of equitable interests to charity have been the subject matter of commentary and case law for some time, this area developed in significant measure after the 1991 release of the decision in *O'Brien Estate v. Minister of National Revenue.*[1]

In *O'Brien* the settlor established a trust under his will that left the residue of his estate in trust with the income of the trust to be applied for the benefit of his nephew during his lifetime, and with the capital to be given at the nephew's death to St. Augustine's Seminary, a registered charity. No capital encroachments could be made for the nephew. In filing the year of death return for the settlor, and while the nephew was still very much alive and enjoying the income from the trust, the Settlor's personal representatives claimed tax relief on account of the deferred charitable donation. The court allowed the claim in a decision that canvassed earlier law and provided some guidance for the future.

1 [1991] 2 C.T.C. 2747, 46 E.T.R. 212, 91 D.T.C. 1349, 1991 CarswellNat 657 (T.C.C.) (referenced to as "O'Brien").

(B) Requirements For A Charitable Remainder Trust

For a trust to qualify as a charitable remainder trust and the settlement of property to qualify as an immediate charitable donation, the following requirements have to be met:

- The capital beneficiary must be a qualified donee, either as a registered charity or one of certain other organizations described in subsections 110.1(1) or 118.1(1).[2] This requirement is met if the capital beneficiary is a registered charitable foundation.[3] It is also met if the capital beneficiary is a U.S. charity.[4]

2 M.N.R., Interpretation Bulletin IT-226R, "Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust" (November 29, 1991), at paragraph 1.

3 M.N.R., Technical Interpretation 1999-0007035, "Directed Gift Remainder Interests" (February 8, 2000) (care has to be taken in gifting property, such as houses, to avoid the operation of subsection 118.1(16) which would have the effect of reducing the value of the gift to nil when the settlor and the foundation are related and the settlor is allowed continued use of the property). Also see M.N.R. Technical Interpretation 9336665, "Irrevocable Charitable Remainder Trust" (January 1, 1993) (including commentary relating to disbursement quotas).

4 M.N.R., Advance Ruling 9600933, "Gift of Residual Capital Interest in Trust" (January 1, 1996) (but see comments as to limits on tax relief in some circumstances under the terms of the Canada-U.S. Tax Convention).

- The value of the equitable interest created in favour of the capital beneficiary at the time the property is contributed to the trust must be capable of determination.[5]
- The settlement of capital into the trust must be a gift. To qualify as a gift in the eyes of CRA in these circumstances the following requirements must be met:[6]
    - The settlor must voluntarily transfer property to the trustees of the trust, without consideration and with no expectation of reward to the settlor or to any person designated by the settlor. More broadly stated, the transfer must be without expectation of right, privilege, material benefit or advantage.[7]
  - The property must vest in the capital beneficiary at the time it is transferred into the trust, even though the ultimate transfer of property to the capital beneficiary is deferred. A gift is said by CRA to be vested if:
    - The capital beneficiary is in existence and ascertained;
    - The size of the capital beneficiary's interest is ascertained;
    - There are no unsatisfied conditions standing between the capital beneficiary and its eventual entitlement to the property;
    - The transfer of the property to the trustees of the trust must be irrevocable; and
    - The terms of trust must be such that the capital beneficiary will eventually receive full ownership and possession of the property transferred into the trust. This requirement is dealt with at greater length later in the section of this paper entitled "Terms of Trust and Access to Capital."

CRA takes the position that the transfer of property to the trust in the above circumstances creates an

[5] See the material discussed later in this section under the title "Valuation Issues."

[6] M.N.R., Interpretation Bulletin IT-226R, "Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust" (November 29, 1991), at paragraph 2 (the requirements set out by CRA being paraphrased and expanded here).

[7] M.N.R., Technical Interpretation 1999-0006995, "Charitable Remainder Trusts" (February 15, 2000).

immediate gift to the charity of an equitable interest in the trust[8] and, to the extent that such equitable interest can be valued and quantified, the settlor is entitled to qualify the gift as an immediate charitable donation when the settlor files their personal or corporate tax return.[9]

It appears that all of the capital should be contributed at once, and not in a series of contributions: CRA may not accept a second settlement of capital into the same trust as qualifying for treatment as a gift to a charitable remainder trust;[10] but has expressed a contrary view on the same point. Caution suggests making one contribution, rather than a series, as the treatment of multiple contributions currently remains unclear.

8 M.N.R., Interpretation Bulletin IT-226R, "Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust" (November 29, 1991), at paragraphs 3 and 4. Also see M.N.R., Technical Interpretation 1999-0006995, "Charitable Remainder Trusts" (February 15, 2000) ("The property which we consider to have been gifted to the qualified donee is not the property actually transferred to the trust by the settlor, but rather the equitable interest in the trust. The trust has received the property. The qualified donee has received an interest in the trust.").

9 M.N.R., Interpretation Bulletin IT-226R, "Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust" (November 29, 1991), at paragraphs 3 and 4.

10 M.N.R., Technical Interpretation 2001-0101845, "Charitable Remainder Trusts" (January 14, 2002). The reasoning expressed with this interpretation is not compelling,

(C) Terms of Trust and Access to Capital

As indicated earlier, CRA takes the position that the transfer of property into the trust must qualify as a gift, which requires that the capital beneficiary eventually receives full ownership and possession of the property transferred into the trust. CRA expresses this requirement strictly, stating that the language of the trust must be "iron clad," [11] and permit absolutely no encroachment on capital, whether mandatory or discretionary. Further, the terms of trust cannot allow the trustees to distribute capital gains income to income beneficiaries, to distribute returns of capital from mutual funds to income beneficiaries, or to pay expenses of the trust from capital, as each of these would be construed by CRA to be an encroachment on capital disentitling the trust from treatment as a charitable remainder trust.[12] CRA might find it difficult to maintain the strict view it has expressed. The *O'Brien* case is

11 A phrase suggested in M.N.R., Technical Interpretation 9414195, "Pooled Fund Remainder Interest Charitable Trust" (September 21, 1994).

12 M.N.R., Technical Interpretation 2001-0086825, "Charitable Remainder Trust" (July 24, 2001) (Adding "Restrictions on distributions to the donee where the capital of the trust is below a threshold amount does not alleviate the potential for the erosion of capital.").

binding on CRA and clearly allows a trust to contain more permissive language while qualifying at the same time for treatment as a charitable remainder trust:

- A power to encroach on capital is permitted in some circumstances. The terms of the trust in *O'Brien* included a power to encroach on capital, as well as on income, for the purpose of effectually carrying on any business owned by the settlor at death, a clause that the court described as part of the boilerplate of the trust document. The court held that a power to encroach on capital is not fatal where there is no reasonable possibility on the facts of the case that the clause would result in a depletion of capital and that the exercise of such power would result in imprudent behaviour on the part of the trustees.[13] The settlor did not, in fact, own a business of any kind at the time of death and the exercise of the clause was highly improbable. A very different situation arises when the terms of trust contain a clear and express power to encroach on capital for the benefit of a beneficiary other than the intended qualifying donee. Where this is the case, the trust will not qualify for treatment as a charitable remainder trust.[14]

- Broadly stated administrative powers also appear to be permitted, even if their exercise could, conceivably, result in a depletion of capital. The terms of trust in *O'Brien* contained a broad power to deal with securities owned by the settlor, giving the trustees the full power to deal with the securities in any manner that would have been available to the settlor while living.[15] That would, in theory, include the power to squander the securities or act irresponsibly with them, putting the capital at risk. The terms of trust also contained a broad

13 *O'Brien Estate v. Minister of National Revenue*, [1991] 2 C.T.C. 2747, 46 E.T.R. 212, 91 D.T.C. 1349, 1991 CarswellNat 657 (T.C.C.), at paragraph 15.

14 *O'Brien Estate v. Minister of National Revenue*, [1991] 2 C.T.C. 2747, 46 E.T.R. 212, 91 D.T.C. 1349, 1991 CarswellNat 657 (T.C.C.), at paragraphs 12 and 14. Also see the cases cited in the *O'Brien* case on this point: *Halley Estate v. Minister of National Revenue*, [1963] C.T.C. 108, [1963] Ex. C.R. 372, 63 D.T.C. 1090, 1963 CarswellNat 339 (Exchequer Court of Canada), affirmed at 63 D.T.C. 1359, [1963] S.C.R. 5, 1963 CarswellNat 410; and *Ansell Estate v. Minister of National Revenue*, [1966] C.T.C. 785, 66 D.T.C. 5508.

15 *O'Brien Estate v. Minister of National Revenue*, [1991] 2 C.T.C. 2747, 46 E.T.R. 212, 91 D.T.C. 1349, 1991 CarswellNat 657 (T.C.C.), at paragraph 6.

discretionary authority to invest funds,[16] that could in theory carry with it the opportunity to put the capital at risk through speculative investments. The court focused on the obligation of the trustees to act prudently and concluded that there was no reasonable probability that the trustees would exercise the powers in such a way as to result in a depletion of capital.[17]

If the terms of the trust disqualify it from treatment as a charitable remainder trust the settlor or the trustees might consider making an effort to "untaint" the trust later, by way of a variation or by disclaimer.[18]

(D) Valuation Issues

A transfer to a charitable remainder trust raises two valuation issues.

First, what is the value of the property for purposes of the disposition by the settlor and also what is the value of the property to the trust for subsequent cost base calculations? This value is relevant for purposes of determining the capital gains treatment to the trust in respect of any future disposition. Generally speaking, the settlor disposes of the property and the trust acquires the property at its fair market value.[19]

Second, since the charity is viewed as receiving a concurrent gift of an equitable interest in the trust, what is the value of the equitable interest to the charity? This issue is relevant to the calculation of the amount to be inserted in the tax receipt and claimed by the settlor as a deduction or credit in the calculation of the settlor's corporate or personal income taxes. Where the value for the equitable interest cannot reasonably be determined, no deduction or tax credit in respect of the donation will

16 *O'Brien Estate v. Minister of National Revenue*, [1991] 2 C.T.C. 2747, 46 E.T.R. 212, 91 D.T.C. 1349, 1991 CarswellNat 657 (T.C.C.), at paragraphs 6 and 7.

17 *O'Brien Estate v. Minister of National Revenue*, [1991] 2 C.T.C. 2747, 46 E.T.R. 212, 91 D.T.C. 1349, 1991 CarswellNat 657 (T.C.C.), at paragraphs 6 and 12 ("Having regard to the long established duty imposed on trustees,…I hold that the wide powers granted to the appellants as the Testator's executors create no greater possibility for the dissipation of the capital of the estate than any other reasonably remote possibility like the sudden collapse of the stock market, excessive inflation over a period of years or the failure of the Canadian economy.").

18 See the discussion appearing later under the title "Gifts By Variation, Disclaimer, or Contingency."

19 M.N.R., Technical Interpretation 9641435, "Charitable Remainder Trust – Cost of Property to Trust" (May 22, 1997). For more detail on this point, see section * entitled " Other Tax Consequences for Settlor."

be allowed,[20] and a registered charity or other qualified donee is not permitted under the Act to issue a donation receipt where it cannot reasonably determine the value of the gift.[21]

The court in *O'Brien* commented on and approved[22] the following valuation protocol used by an expert witness to calculate the charitable deduction or credit:

- The valuation process commences by valuing the property being settled into the trust at its fair market value as of the date of settlement (referred to below as the "FMV at Settlement"). This will be the same value referred to above for the purpose of capital gains calculations. In *O'Brien*, the trust was established in a will and the settlement date was taken to be the date of death of the testator. The fair market value of the estate assets at the time of the death was $558,700.00.
- After that value is determined, the following question is posed: How much capital would have to be set aside now, as of the date of settlement, to produce a sum of money equal to the FMV at Settlement later, as of the projected date on which the capital would in fact be received by the charity (referred to here as the "Projected Date of Contribution")? In *O'Brien* the Projected Date of Contribution was the projected date of death of the lifetime income beneficiary. The calculations were said to hinge on two factors:
    - First, ascertaining the Projected Date of Contribution. The expert consulted life expectancy tables for the lifetime beneficiary, and used life insurance tables to adjust for a medical condition that the beneficiary suffered, to project the date on which the beneficiary would, statistically, be most likely to die.
    - Second, the interest rate at the time of settlement was ascertained for the purpose of the

20 M.N.R., Interpretation Bulletin IT-226R, "Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust" (November 29, 1991), at paragraph 6.

21 M.N.R., Technical Interpretation 1999-0006995, "Charitable Remainder Trusts" (February 15, 2000).

22 *O'Brien Estate v. Minister of National Revenue*, [1991] 2 C.T.C. 2747, 46 E.T.R. 212, 91 D.T.C. 1349, 1991 CarswellNat 657 (T.C.C.), at paragraphs 8, 9 and 17.

calculations. This was described as "easily accessible."

Based on that calculation, the expert concluded that the sum of $49,361.15[23] would have to be set aside as of the date of settlement to provide $558,700.00 to the charity on the projected date when the income beneficiary would die. Thus, the testator was entitled to tax relief in the year of death based on a charitable donation in the amount of $49,361.15.

CRA has adopted the principles and approach taken in *O'Brien*, stating that the valuation is to be conducted by determining what a person would pay today in order to have the capital of the trust "x" years from now,[24] and that the general approach is to value the interests taking into consideration the fair market value of the property, current interest rates, the life expectancy of any income beneficiaries or beneficiaries entitled to the use of the property, plus any other factors deemed relevant on a case-by-case basis.[25] 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.[26] The terms of the trust may, for example, speak to investment style and have an impact on interest rates. This can be subtle and may evade consideration in the valuation process, as might be the case in dealing with a provision that makes the even hand rule inapplicable.[27]

CRA has declined to adopt guidelines or to direct practitioners to preferred mortality tables or discount rates for use in those calculations,[28] leaving it to the settlor and the capital beneficiary, or more precisely the valuation specialist[29] (presumably an actuary) retained for that purpose, to select appropriate tables

23 This dollar amount is low as the lifetime beneficiary in the *O'Brien* decision was young and had a long future life expectancy. If the lifetime beneficiary were in his eighties, the dollar amount would be far larger and would begin to approach the total amount settled into the trust.

24 M.N.R., Technical Interpretation 9336665, "Irrevocable Charitable Remainder Trust" (January 1, 1993); M.N.R., Technical Interpretation 9414195, "Pooled Fund Remainder Interest Charitable Trust" (September 21, 1994).

25 M.N.R., Interpretation Bulletin IT-226R, "Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust" (November 29, 1991), at paragraph 5.

26 M.N.R., Interpretation Bulletin IT-226R, "Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust" (November 29, 1991), at paragraph 5.

27 See the discussion later under the heading "Things You Need To Know" entitled "Impact of the Even Handed Rule."

28 M.N.R., Technical Interpretation 2000-M020417, "Gift Planner Symposium Q & A" (January 17, 2000), at Question 1.

29 M.N.R., Technical Interpretation 9336665, "Irrevocable Charitable Remainder Trust" (January 1, 1993).

and rates[30] depending on the circumstances surrounding the particular gift. CRA also generally declines to issue advance rulings to confirm dollar figures on a valuation issue.[31]

CRA has also added the following cautions:

- "In the case of some types of property held by a charitable remainder trust, such as shares in a private corporation, a reasonable determination of the fair market value of the equitable interest in the trust may not be possible."[32]
- "In the case of property other than real property, the longer the period before full ownership of the property is passed to the charity, the more difficult it is to establish its value."[33]
- "… in our view, it would be very difficult to determine the value of an equitable interest in a trust…where the property of the trust would consist of various investments."[34]

(E) Factors Relating to the Property

If the property consists of paintings, sculptures or other easily movable articles, they have to be protected from theft or other loss while they are held by the trustees or, failing that, CRA has suggested that the arrangements may not qualify the gift for an immediate treatment as a charitable gift, on the grounds that it is not evident that the capital

30 M.N.R., Technical interpretation 9603885, "Valuation of Interest in charitable Remainder Trust" (February 26, 1996) ("…the appropriate discount rate to use is a question of fact in each case and it should approximate the rates for similar risk instruments. In our view, the prescribed interest rate would not be an appropriate discount rate in all cases, since it does not take the risk element inherent in certain investments into consideration.")

31 M.N.R. Technical Interpretation 9336665, "Irrevocable Charitable Remainder Trust" (January 1, 1993) (citing paragraphs 14(f) and (j) of IC-70-6R2, "the Department does not usually provide advance income tax rulings on the determination of fair market value or questions of fact.").

32 M.N.R., Technical Interpretation 1999-0006995, "Charitable Remainder Trusts" (February 15, 2000). The same conclusion is expressed and repeated in M.N.R., Technical Interpretation 1999-0006945, "Non-Qualifying Security and Dividend" (February 1, 2000), and in M.N.R., Technical Interpretation 9224505, "Charitable Remainder Trust" (October 21, 1992). The rationale for these remarks appears to be based on difficulties in valuing a small, closely held, private corporation. This would be particularly true if the corporation operated a business, but would presumably be less of a problem, or no problem at all, where the company was a holding company and owned no assets other than a collection of easily valued property such as cash and GIC's.

33 M.N.R., Interpretation Bulletin IT-226R, "Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust" (November 29, 1991), at paragraph 5.

34 M.N.R., Technical Interpretation 9414195, "Pooled Fund Remainder Interest Charitable Trust" (September 21, 1994). This comment appears to be difficult to reconcile with the *O'Brien* decision, where, firstly, the power to invest in a prudent collection of varying investment types was held to be a non-factor, and, secondly, the basic protocol applied in the present value calculation involves an answer to a hypothetical question and is based on interest rates in place at the time of the donation. If the terms of trust demanded on a mandatory basis that the assets be placed in speculative investments with a high risk of dissipation, one could conclude that *a gift may not have been made*, but it should be irrelevant from the perspective of valuation.

beneficiary will eventually receive possession of the property transferred into the trust.[35]

If Canadian cultural property is donated through a charitable remainder trust, the gift will not qualify for inclusion in the deceased's "total cultural gifts" under subsection 118.1(1) of the Act.[36]

A gift of shares in a private corporation can be problematic, in addition to the valuation problems referred to earlier, if CRA determines that the main reason for using a charitable remainder trust in the circumstances is to circumvent the rules in subsection 118.1(13) or (16) of the Act, as might be the case where the shares are non-qualifying securities under 118.1(18), in which case CRA has warned that it will consider the application of GAAR.[37]

(F) Claiming the Deduction or Tax Credit

The settlor can be an individual, and use the tax receipt to secure a non-refundable federal tax credit,[38] or a corporation, and use the tax receipt as a deduction in computing taxable income.[39] CRA takes the position that the gift must be supported by an official donation receipt issued under Part XXXV of the Regulations.[40] If the charity in question were to refuse to issue a receipt, on the grounds that the gift will not in fact be received until some future date, it

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35 M.N.R., Interpretation Bulletin IT-226R, "Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust" (November 29, 1991), at paragraph 4. This also suggests that if property is subject to loss or destruction, the terms of trust should provide for mandatory insurance on the property for its full fair market value – a sailing boat held in a trust where insurance was expressly optional, and where the income beneficiaries were entitled to the use of the item, may not allow the trust to qualify as a charitable remainder trust. Query – would a provision calling for mandatory property insurance be enough to save a charitable remainder trust containing artwork or a boat?

36 M.N.R., Technical Interpretation 9524775, "Donation of Residual Interest" (January 4, 1996) (on the grounds that a gift of an "object" is necessary to qualify for that treatment and the gift of an equitable interest in a trust is not the gift of an object).

37 M.N.R., Technical Interpretation 1999-0006945, "Non-Qualifying Security and Dividend" (February 1, 2000) ("…if, having regard to the circumstances, it is determined that the main reason for using a charitable remainder trust is to circumvent the rules in subsection 118.1(13) or (16) of the Act, consideration will be given to the possible application of GARR" as where the shares are non-qualifying securities under 118.1(18)); M.N.R., Special Projects 9807000, "Conference of Advanced Life Underwriting" (May 12, 1998) (Question 12).

38 Subsection 118.1(3).

39 Subsection 110.1(1).

40 M.N.R., Interpretation Bulletin IT-226R, "Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust" (November 29, 1991), at paragraph 2.

may still be possible to claim the charitable deduction or credit.[41]

(G) Other Tax Consequences for Settlor

The transfer of the property from the settlor to the trust will normally give rise to a disposition, triggering capital gains or losses, unless the trust avoids that treatment as a spousal trust, alter ego trust, joint spousal trust, or joint partner trust. When a disposition occurs, the proceeds of disposition for the settlor will be deemed to be the fair market value of the whole of the property at the time it is settled into the trust by transfer from the settlor to the trustees. At one point, this was subject to an exception in cases where the settlor retained an income interest in the trust. CRA proceeded on the basis that the settlor retained some beneficial ownership, attributable to the income interest, and only disposed of the beneficial ownership attributable to the capital remainder and, therefore, only incurred a gain attributable to the capital remainder. CRA changed their administrative position in 1996, and their current view is that there is a disposition of the whole property transferred into the trust, even if the settlor takes back an income interest in the trust.[42]

Where the fair market value of the property at the time of the disposition exceeds its adjusted cost base, the taxpayer or their personal representative will be entitled to make the election provided for under subsection 118.1(6), providing for an elected amount, not greater than the FMV and not less that the adjusted cost base of the capital property, to be considered as both the proceeds of disposition and the amount of the gift.[43] The same holds true for a corporate settlor under 110.1(3). The elected amount for the purposes of capital gain and loss calculations is not relevant in the valuation of the equitable

41 *O'Brien Estate v. Minister of National Revenue*, [1991] 2 C.T.C. 2747, 46 E.T.R. 212, 91 D.T.C. 1349, 1991 CarswellNat 657 (T.C.C.), at paragraphs 18 to 22 (the provisions of the ITA as they were at the time of the O'Brien decision would have to be carefully compared to the equivalent provisions of the ITA as they exist today in assessing the outcome).

42 M.N.R., Technical Interpretation 2000-M020417, "Gift Planner Symposium Q & A" (January 17, 2000), at Question 2.

43 M.N.R., Interpretation Bulletin IT-226R, "Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust" (November 29, 1991), at paragraph 8; also see M.N.R., Technical Interpretation 2000-M020417, "Gift Planner Symposium Q & A" (January 17, 2000), at Question 2 (describing this as an administrative policy, inconsistent with the actual wording of the Act, and under review, adding that taxpayers will be entitled to rely on the current wording of paragraph 8 of IT-226R in making gifts to charitable remainder trusts during that review).

interest that is received by the qualified donee at the time of the gift.[44]

The capital gains inclusion rate is always the standard 50% imposed under the Act. The reduced rate of 25% available under paragraph 38(a.1) is not available when listed securities are gifted to a charitable remainder trust, even though the lower rate could have been accessed by direct gift made by the settlor to the qualified donee.[45]

Transferring an RRSP to a charitable remainder trust as a designated beneficiary does not avoid the income taxes otherwise payable by the settlor as annuitant of the RRSP when the funds are withdrawn.[46]

44 M.N.R., Technical Interpretation 1999-0006995, "Charitable Remainder Trusts" (February 15, 2000) ("…in situations where the elected amount is greater than the fair market value of the residual interest in the property, the elected amount will represent the taxpayer's proceeds of disposition for the purposes of determining any gain or loss on the transfer of the property to the trust, but the amount of the donation eligible for a tax credit will not be more than the fair market value of the residual interest. The Agency cannot administratively allow a donation tax credit based on an amount which exceeds the actual value of a gift received by the charity.").

45 M.N.R., Technical Interpretation 2000-M020417, "Gift Planner Symposium Q & A" (January 17, 2000), at Question 3 (on the grounds that the listed security is being gifted to the trust, not the charity); also see M.N.R., Technical Interpretation 9917615, "Gift Of Residual Interest In A Trust" (June 30, 1999).

46 M.N.R., Technical Interpretation 9902085, "Taxation Of Amounts Transferred From An RRSP" (June 29, 1999).

(H) Ongoing Taxation of The Charitable Remainder Trust

The charitable remainder trust is taxed like any other trust once it has been constituted and is up and running. It does not enjoy any form of tax-exempt status. Capital gains or losses on dispositions of property in the trust are subject to tax within the trust and must be reported on the T3 return for the trust, however, the trust may under subsection 104(21) designate capital gains to have been paid out to the tax-exempt capital beneficiary of the trust such that the capital gains realized by the trust would be considered to be capital gains of the tax exempt beneficiary.[47] CRA has said that the trust deed must make it clear that any capital gains realized by the trust will be paid or are payable to the qualified donees, before a designation under subsection 104(21) of the Act can be made in their favour.[48] This clause might be inserted into the terms of charitable remainder trusts as a matter of course.

47 M.N.R., Technical Interpretation 1999-0006995, "Charitable Remainder Trusts" (February 15, 2000).

48 M.N.R., Technical Interpretation 9429135, "Pooled Fund Remainder Interest Charitable Trusts" (January 26, 1995).

The capital of the trust must be transferred to the registered charity on the death of the income beneficiary, or the occurrence of any other triggering event specified within the terms of the particular trust. When that occurs CRA treats the transfer of property to the trust as a distribution of capital under subsection 107(2) of the Act to a capital beneficiary in satisfaction of the beneficiary's capital interest in the trust.[49] This does not qualify as a charitable gift. Thus, tax relief is limited to the front-end of the structure and is not available twice.That is, tax relief on account of the charitable gift occurs first and only at the date the capital is settled in the trust and not a second time, when it is ultimately transferred to the qualified donee.

(I) Types of Trusts That Qualify

A charitable remainder trust can be testamentary or inter vivos.[50]

[49] M.N.R., Technical Interpretation 1999-0006995, "Charitable Remainder Trusts" (February 15, 2000).

[50] M.N.R., Interpretation Bulletin IT-226R, "Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust" (November 29, 1991), at paragraph 3.

As an example of a testamentary trust consider a last will and testament that provides for property to be held in a trust for the benefit of a family member, with all of the income from that property to be paid to them each year as the income beneficiary of the trust, but with the capital to be withheld and maintained in the trust until the death of the family member, without any exception, at which point the property in the trust is to be given to a registered charity named under the terms of the will as the ultimate capital beneficiary. Under those circumstances, and assuming the interest of the trust can be valued and the other technical requirements set out earlier are met, the deceased would be entitled to use the charitable receipt to claim a charitable tax credit in the year of death.[51]

As an example of an *inter vivos* trust, consider a taxpayer who settles property to a trust by transferring it to the trustee, and the trustee is directed under the terms of the trust to pay all of the income earned by the trust back to the settlor each year, who remains as the income beneficiary of the trust for the rest of the settlor's life, and on the death

[51] Subsection 118.1(4).

of the settlor to transfer property to a registered charity. Under those circumstances, and assuming the capital interest of the trust can be valued and the other technical requirements set out earlier are met, the taxpayer settling the trust would be entitled to use the charitable receipt to claim a charitable tax credit in the year in which the gift was made.[52]

Can a spousal trust qualify as a charitable remainder trust?[53] CRA does not appear to have expressed a position on this point. To qualify as a spousal or common-law partner trust, no individual other than the spouse or common-law partner can access the capital of the trust during their lifetime. Under a charitable remainder trust, no access to capital is allowed during the life of the income beneficiary. These seemingly two conflicting requirements can be met within the same trust with a provision which stipulates that the capital of the trust be preserved until the death of the spouse or common-law partner and with a prohibition on encroachment of capital on behalf of any beneficiary during the life of the spouse or common-law partner. Further, to qualify as a spousal or common-law partner trust the spouse or common-law partner must be entitled to all of the income of the trust during their lifetime. This is consistent with the requirements for a charitable remainder trust provided that the income beneficiary is the spouse or common-law partner. Where are the expenses of the trust to be taken from? If the expenses can be taken from capital, then the trust will not qualify as a charitable remainder trust. Thus, if the trust is to be a charitable remainder trust, the expenses must be expressly taken from income, not capital. Care must be taken to ensure that the only expenses to be borne by the trust are among those permitted list of expenses that can be paid from a qualifying spousal or common-law partner trust.[54]

Can an alter ego trust qualify as a charitable remainder trust? The analysis on this point would parallel the analysis above dealing with spousal trusts, and there should be no impediment to structuring an alter ego trust to qualify as a charitable remainder trust provided that the expenses of the trust are expressly taken from income and not from capital.

52 Subsection 118.1(3)

53 This paragraph refers to spousal trusts only, but the comments will be equally applicable to common-law partner trusts.

54 See the section of chapter * entitled "[perfect cross reference]."

CRA has declined to comment, however, on whether a joint spousal trust or joint common-law partner trust will qualify as a charitable remainder trust.[55] In theory, there should be no impediment. The essence of the situation remains the same. The trust would simply defer the capital gift during two lives rather than one. The possibility for structuring charitable remainder trusts with multiple lifetime income beneficiaries is discussed later at greater length.[56] Until CRA comments on this point, some estate planners may choose to avoid the use of joint spousal or joint common law partner trusts when setting up charitable remainder trusts.

(J) Planning Opportunities and Considerations

(I) Tax Holidays

Where a client plans to leave a significant sum of money to a charity, and the client does not have any objection to putting the capital beyond their reach, a charitable remainder trust can be an attractive option. The tax savings are immediate, and in the right circumstances can create a "tax holiday" for the settlor. The older the beneficiary, the better this works, and such structures will carry more appeal to potential settlors in their seventies and eighties than to settlors in their forties and fifties.

(II) Planning Considerations Dealing With Couples

In dealing with a couple, and assuming they wish to establish a charitable remainder trust, at issue is whether they establish one trust, in the form of a joint spousal trust or common law partner trust, or whether they establish a pair of trusts, acting as the sole settlor and income beneficiary of each, as would be the case with a pair of alter ego trusts. A variety of considerations exist:

- Size of the tax receipt. If the property is to be transferred to the qualified donee on a joint last to die basis, the tax receipt will be for a lower amount than would be available if the same property were divided into two

[55] M.N.R., Technical Interpretation 9807185, "Charitable Remainder Trust" (October 29, 1998) (citing a review of IT 226R, a review that, if it is still ongoing, has yet to result in amendments to the IT).

[56] See the section of text appearing below and entitled "Multiple Income Beneficiaries."

parts and settled into two separate trusts. From an actuarial standpoint, the date of last death is a date farther removed than the date of death of each individual partner, even if both partners are relatively the same age. The farther the date of death, the lower the net present value of the current gift amount. The joint last to die structure guarantees that none of the property will be transferred to the charity until both partners are deceased. With separate trusts, some of the property will be transferred to the charity on the date of the first death.

- Size of the income stream. If two trusts are employed, the income stream will decrease when the first partner dies. The joint structure ensures full access to income for the whole of both lives. This is an important factor which should be weighed against a larger charitable tax credit as would be the case in the former situation. In most cases, retention of the income stream will take precedence.

- Certainty of CRA position. Two issues should be considered under this point. First, CRA has declined to comment on whether a joint partner trust or joint common law partner trust will qualify as a charitable remainder trust;[57] conversely CRA commentary consistently allows for charitable remainder trusts with single income beneficiaries. Second, if the two income beneficiaries are also the settlors, as will sometimes be the case, particularly if jointly owned property is settled into the trust, there may be some issue as to who is entitled to the charitable receipts. The value of the equitable interest will have to be allocated between the contributions of the two settlors and, where that allocation is problematic, it may complicate the transaction.

[57] See the material at page 25 on this point under the title "Multiple Income Beneficiaries."

(III) Concurrent Strategies

There may be some opportunities to use concurrent strategies to make the use of a charitable remainder trust more attractive.

A person interested in being the settlor of a charitable remainder trust might find that an additional benefit can be secured if they are in a position to engage in jurisdiction shopping. To achieve this result the charitable remainder trust must be set up and structured to avoid attribution of income under subsection 75(2).[58] If this can be successfully achieved, and the trust is resident for income tax purposes in a low income tax jurisdiction, (such as Alberta), then options exist relating to the taxation of income generated in the trust. Income can be paid out to and spent by a settlor in a high income tax jurisdiction and, at the same time, be designated under subsections 104(13.1) and (13.2) to be trust income and be taxed on the trust return in a low income tax jurisdiction.[59] This would be attractive if the income beneficiary is otherwise taxed at top marginal rates. It generally bears examination only where large amounts of capital are settled into the trust or where the settlor has access to a trustee, such as a family member, who is resident in the low tax jurisdiction and is willing to act as trustee for little or no compensation.

If the trust is concurrently an alter ego trust, no capital gains or losses will be triggered when the property is transferred to the trust. When the lifetime beneficiary dies, and the capital is transferred from the alter ego trust to the qualified donee, all deferred gains or losses become subject to tax on the T3 Return for the trust. The trustees might, however, try to invoke subsection 104(21), discussed earlier, to flow such capital gains to a tax exempt beneficiary.[60]

[58] The major hurdle in planning to avoid 75(2) is typically finding a settlor willing to give up any possible access to the capital after it has been inserted in the trust. That hurdle has already been cleared by a client wishing to settle property into a charitable remainder trust with a view to securing the immediate tax relief and benefiting charity.

[59] An *inter vivos* trust pays taxes at top federal provincial rates, but those rates are significantly lower in some jurisdictions than in others.

[60] This strategy has not been commented on by CRA. It might attract GAAR attention under section 245. The structure would have to be carefully put together and an advance ruling might be advisable as well.

(IV) Conservative Planning

There are uncertainties and apparent contradictions on CRA's positions dealing with charitable remainder trusts. CRA has indicated that it is rewriting the interpretation bulletin dealing with gifts to charities of equitable interests in trusts. Conservative practitioners may wish to obtain an advance tax ruling before setting up charitable remainder trusts or, alternatively, to structure charitable remainder trusts which comply with CRA's strictest published commentaries. At the most conservative end of the spectrum, a charitable remainder trust might be structured on the following terms:

- One settlor.
- One income beneficiary.
- One qualified donee.
- Cash, bonds, GIC's, or other easily valued property settled in the trust, as a single transfer and not in stages or a series of instalments.
- Provisions that
    - remove any discretion to encroach on capital for any reason, with careful regard to sanitizing any "boilerplate" provisions that might provide access to capital, and
    - remove or limit any sweeping administrative powers that could, conceivably, be used to dissipate capital.

(iii) Things You Need To Know

(A) Future Events Other Than Death

While a charitable remainder trust normally defers the transfer of capital to the charity or other qualified donee until the death of the settlor or the death of some other person, such as the settlor's spouse or common-law partner, the capital transfer can also be linked to other future events. As an example, a trust could qualify if the terms of trust stipulated that the capital be held for 20 years and, at the end of that time, be transferred to the charity. In this example, the event triggering the transfer to the charity is known with complete certainty. This simplifies the calculation of the net present value of the charitable gift, thereby eliminating actuarial assistance normally required to predict the life expectancy of a subject life. There is nothing in the case law or in the current positions expressed by CRA which would limit the triggering event to the death of an income beneficiary, provided always that the triggering event can be determined with some statistical certainty.

(B) Impact of the Even Hand Rule

As suggested earlier, the terms of the trust document may deal with the "even hand rule" and, if so, it may have an impact on valuation.

The even hand rule provides, *inter alia*, that trustees cannot make decisions that favour current income beneficiaries if it harms the interests of future capital beneficiaries, and *vice versa*.Trustees must deal with both sets of beneficiaries fairly and with a view to their best interests. That means selecting investments balanced between those producing high levels of income, which favour the lifetime income beneficiary, and investments that foster capital appreciation, which favour the capital beneficiary. The trustees must determine and apply an appropriate balance that will treat both sets of beneficiaries with an even hand. That is not the case if a specific provision is inserted in the trust that relieves the trustees of their obligation to comply with the even hand rule. Since the settlor, or a family member of the settlor, is typically the lifetime beneficiary, a clause frequently finds its way into the trust document that allows the trustees to disregard the rule or to expressly select investments that maximize income generation at the expense of capital appreciation. Whether that clause is general or specific, the selection of interest rates during the valuation of the gift to charity will, presumably, be sensitive to the presence or absence of the clause. At the drafting stages, where the primary objective is to maximize the charitable receipt, the trust document should be silent as to the even hand rule or expressly preserve it. Where the primary intent is to ensure the ongoing comfort of the income beneficiary, the rule may be expressly made inoperable or language may be inserted allowing income to be maximized, in which case the charitable receipt may be issued on the basis of a lower valuation.

(C) Gift of Income Interest To Charity

Does a gift of an income interest in a trust qualify as a charitable donation? CRA does not appear to have a consistent position on this point, and the issue should be approached with caution.

The following hypothetical situation illustrates the issue. A settlor purchases a $1,000,000 Government of Canada bond and transfers it to a trust established for the purpose of benefiting two unrelated charitable organizations. Charity A is the income beneficiary under the terms of trust, and is to receive all of the income from the bond for five years. Charity B is the capital beneficiary under the terms of trust, and is to receive the bond as a capital distribution from the trust at the end of the five years.[61] The gift of capital to charity B, receiving the capital at the end of the five years, would clearly qualify as an equitable interest in a trust and as a charitable gift. The gift of the income interest to charity A, receiving an income stream over five years, is more controversial.

In expressly dealing with this hypothetical example CRA expressed the position that both the capital interest and the income interest would be considered to be charitable gifts for income tax purposes.[62] They declined to comment on valuation issues posed at the same time[63] other than remarking that the income interest and the capital interest should have a combined value equal to the fair market value of the bond at the time it is settled into the trust by transfer to the trustees.

CRA had earlier expressed contrary views on this matter:

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[61] This hypothetical scenario was considered by CRA in M.N.R., Special Projects 9908430, "CALU Conference May 1999" (May 1, 1999) at Question 11 ("Charitable Trust") (discussed at length below).

[62] M.N.R., Special Projects 9908430, "CALU Conference May 1999" (May 1, 1999) at Question 11 ("Charitable Trust") ("…if it can ascertained from the terms of the trust that a gift of an income interest has been made to Charity A and a gift of an equitable interest has been made to Charity B, the donor will be considered to have made charitable gifts for income tax purposes.").

[63] The specific hypothetical example is a bad one. Are the expenses of the trust to be paid from income or capital? If capital, the charity that is the capital beneficiary is not receiving all of the capital, and the valuation issue centres on whether the level of expense can be predicted with sufficient certainty to allow for the calculation of the net present value. Presumably not. If the expenses are to be paid from income, then the same problems arise with valuing the income interest in the trust. These problems arise in this hypothetical example because both the income interest and the capital interest are being donated to charity. Nothing in this brief analysis would preclude an income interest to a charity as qualifying as a charitable gift.

- For instance, CRA had taken the position and stated that an income interest in a trust cannot be a charitable gift for tax purposes on the grounds that "an income interest in a testamentary trust cannot, by definition, be property of the testator as the trust is not established until death. Therefore, the testator cannot transfer, by will, that which is not his property."[64]

- CRA had also taken the view in another hypothetical example, under which an *inter vivos* trust is established on terms providing that all of the income in each year would be paid to a registered charity, and the settlor would receive an amount of up to $2,000 per month in capital until the death of the settlor that there is no charitable gift, on the grounds that the value of the residual interest and the income interest "were not reasonably ascertainable in that the donor is entitled to receive up to $2,000 of capital per month."[65]

(D) More Than One Charity As Capital Beneficiaries

A charitable remainder trust with multiple capital beneficiaries, sometimes referred to as a pooled fund remainder interest charitable trust, has been the subject of comment by CRA.[66] Nothing in the case law or under the Act appears to preclude multiple capital beneficiaries, but this appears to be an unsettled area with CRA and should be approached by practitioners with caution.

CRA was asked to comment on a proposal under which a trust or trusts would be set up with one or more registered charities or qualified donees as capital beneficiaries, and multiple donations would be received by the trustee from a variety of settlors, each settlor earmarking one of the capital beneficiaries to receive the capital or its equivalent

64 M.N.R., Technical Interpretation 9800137, "Charitable Donations" (April 16, 1998). The reasoning expressed in this technical interpretation is not, it is submitted, compelling.

65 M.N.R., Technical Interpretation 930041A, "Transfer to Charitable Remainder Trust" (January 29, 1993). The comments might hinge on the discretion in paying an amount *up to* $2,000 in monthly income. It is submitted that the conclusion might be different if the terms of trust were altered slightly and the settlor's entitlement to capital was for a full $2,000 per month for ten years, in circumstances where there was more than adequate capital to sustain that level of payment over that time frame. An actuary might well be able to value the income interest under those circumstances.

66 M.N.R., Technical Interpretation 9414195, "Pooled Fund Remainder Interest Charitable Trust" (September 21, 1994) (general comments); M.N.R., Technical Interpretation 9429135, "Pooled Fund Remainder Interest Charitable Trusts" (January 26, 1995) (designations under subsection 104(21)).

after the death of the settlor. The donations would be used to purchase a variety of investments held on a pooled basis, and each settlor would be granted units in the pool and enjoy income during their respective lifetimes based on the number of units they held. CRA expressed the view that provided the other requirements of a gift were met,[67] each such donation of property could qualify as a gift to a charity of an equitable interest in a trust.[68] Based on the structure of the investment pool, CRA was also of the view however, that it would be unlikely that a tax credit or deduction would be allowed in the circumstances because of valuation problems.[69]

(E) Multiple Income Beneficiaries

The most frequent scenario in setting up a charitable remainder trust involves a single lifetime income beneficiary. A structure with multiple income beneficiaries (and multiple settlors) has been considered acceptable where each beneficiary has the right to income from their own contribution,[70] but more recently CRA has now declined further comment on this issue, stating that it is under review as part of a general review relating to charitable remainder trusts.[71] Conservative practitioners may want to approach this area with caution until CRA has clarified its position on this point.[72]

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67 M.N.R., Interpretation Bulletin IT-226R, "Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust" (November 29, 1991), at paragraph 2 (set out earlier in section * [perfect cross reference]).

68 M.N.R., Technical Interpretation 9414195, "Pooled Fund Remainder Interest Charitable Trust" (September 21, 1994).

69 This position might be subject to dispute and is discussed earlier in the material entitled "Valuation Issues."

70 M.N.R., Technical Interpretation 9414195, "Pooled Fund Remainder Interest Charitable Trust" (September 21, 1994).

71 M.N.R., Technical Interpretation 9807185, "Charitable Remainder Trust" (October 29, 1998) (commentary sought from CRA on a joint interest in property transferred to a charitable remainder trust by a husband and wife who would then enjoy the income from the trust for life, and CRA stating that since "…the Department is currently in the process of reviewing the positions set out in IT-226R, we are unable to provide any comments at this time with respect to your particular situation.").

72 It is submitted that there should be no impediment to structuring a charitable remainder trust with two, or more, income beneficiaries, provided the balance of requirements set out in Interpretation Bulletin IT-226R[72] are met. The trust would simply defer the capital gift over two lives rather than one. There is no valuation issue. Predicting the future date when the last of the lifetime beneficiaries is to die is a common place determination conducted by life insurers in placing joint last-to-die insurance.

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