Charitable Giving and Trusts

Presented for CBA-NS WET and Charites Sections
April 24, 2019
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Introduction

- Summary of “New” Rules
  - Testamentary Trusts/Graduated Rate Estates
  - Life Interest Trusts
  - Estate Donations
- Gifts by LITs
- Charitable Remainder Trusts
- Case Studies on Charitable Donations
  - Donation by Will
  - Donation through Life Interest Trust
- Will/Trust Review
- Planning Principles

What's the difference between death and taxes?

Parliament doesn't meet every year to make death worse.

Summary of “New” Rules – TTs and GREs

- Elimination of graduated rates of taxation for testamentary trusts (TT’s) effective January 1, 2016 – 122(1) amended and (2) repealed
- Top marginal tax rate now applies to trusts created by will and certain estates

TTs and GREs (Cont’d)

Two exceptions:

1. Graduated rate estate (**“GRE”**) – three part test
   - Means (i) an estate that arose on and as a consequence of an individual’s death, (ii) that is a testamentary trust and (iii) continues only for 36 months from date of death

- Must be designated as a GRE by the executors in the estate’s first tax return
- Only one GRE per taxpayer

2. QDT - testamentary trust established for benefit of disabled individual (i.e. eligible for disability tax credit) are exempt – details outside scope of this presentation

TTs and GREs (Cont'd)

- Implications of this change:
  - spousal trusts
  - other tax planned trusts
- Drafting required to ensure benefit from full 36 months
- Took effect for 2016 and later taxation years
- No grandfathering for testamentary trusts and estates already established prior to January 1, 2016
- Practice point – "unwind" current testamentary trusts or revise planning?

TTs and GREs (Cont'd)

- Testamentary trusts must now have a calendar year end:
  - Existing testamentary trusts without a calendar year end were deemed to have a year end that ended on December 31, 2015 – may have had two year ends in 2015
  - Existing estates that were not GREs (i.e. older than 36 months) - same rule
- Should make administration of TT's easier going forward
- Other ancillary changes

TTs and GREs (Cont'd)

- **GREs** (now existing or created later) **are different**
- Can still choose an off-calendar year end BUT lose this status 36 months post date of death (Note – possible to have 4 Y/E's within one GRE although 2 will be short years)
- On loss of status have a deemed year end and thereafter December 31 year end going forward – two year ends in the same year?
- Only a GRE eligible for 164(6) loss carry back and 112 (3.2) loss restriction
- **Only a GRE can make estate donations under the new rules**
- No installment obligation for a GRE
- Graduated tax rates apply

TTs and GREs (Cont’d)

- Note – new 104 (13.3) provides that income paid or payable to a beneficiary can only be taxed in a TT to the extent of any losses in the trust to make taxable income nil

Life Interest Trusts

- Life Interest Trusts (LIT) – trusts which received a rollover on a transfer of property to the trust where a deemed disposition occurs on the death of the surviving life interest beneficiary:
  - Spousal and common-law partner trusts (spouse trusts)
  - Joint spousal and common-law partner trusts (JPTs)
  - Alter ego trusts and self-benefit trusts (AETs)

Life Interest Trusts (Cont'd)

- LIT different than GRE re loss carry back - normal three year carry back rules in 111 apply not 164(6)
- Other differences on charitable gifts – more later

Estate Donations

- Applicable for 2016 and subsequent taxation years for a death that occurred after 2015
- Donations made in a will or by designation under a Registered Retirement Savings Plan, Registered Retirement Income Fund, Tax- Free Savings Account or life insurance policy are no longer deemed to be made by the individual immediately before the individual's death (old rule)
- Donations are now deemed to have been made by the individual's estate at the time the property is transferred to a qualified donee, provided the transfer occurs within 36 months after death

Estate Donations (Cont'd)

- Can be extended by two more years (to five after date of death) if estate only ceased to be a GRE because 36 months expired (helpful if litigation over the estate or difficulty selling assets, etc.)
- The executor/trustee of the individual's estate has the flexibility to allocate the available donation credit among:
  - the taxation year of the estate in which the donation is made
  - an earlier taxation year of the estate **or**
  - the terminal and immediately preceding taxation year of the individual

Estate Donations (Cont’d)

- Note: to obtain the carry back the donation must be made by a GRE within 36 months of death (or the subsequent two years)
  - if estate not a GRE credit only available against the estate’s income in year donation made plus 5 year carry forward
- The prior annual credit limits in year of death and preceding year continue to apply (i.e. 100% or 75% of taxable income)

Estate Donations (Cont’d)

- Property being gifted must be “property that was acquired by the estate on and as a consequence of the death” or “property that was substituted for that property”
- Valuation of donation credit is value on date property transferred to charity – if not cash, could be different than at date of death
- Note – these rules do **NOT** apply to donations made by a LIT

Gifts by Life Interest Trusts

- Donations made by a LIT are less effective than donations made in a will
- Donation credit is limited to 75% of the trust's income (versus 100% if through the will)
- But if can convert capital gain to dividend on private company shares (by redemption), then get 100% deduction when add the gross-up for the dividend tax credit to the 75% limit

Gifts by Life Interest Trust (Cont'd)

- Must draft with discretion (typically coupled with a letter of wishes) in order to obtain **any** donation receipt for the trust – CRA will otherwise consider a directed gift to be a distribution to a capital beneficiary (the "credit problem)
- Timing of death is also a concern as must make the gift out of the trust within **90 days** after the end of the calendar year of the death of the life beneficiary (the "timing problem")
- Estate donation rules (5 year window) **not** applicable to a trust, only a GRE

Charitable Remainder Trusts (CRTs)

- A type of trust that is designed to provide an income interest to one or more individual beneficiaries, and then a future benefit to a charity(s)
- Donor/settlor receives current tax receipt, but charity(s) gets donation later
- Trust terms cannot allow for capital encroachment to the income beneficiary (or only to a limited monetary amount)

Charitable Remainder Trusts (CRTs) (Cont'd)

- Donation receipt based on **present value** of the **future gift**
- Factors are:
  - Age and actuarial mortality of life beneficiary (time period)
  - Interest/discount rates over time period
  - Current fair market value of property settled into the CRT
- Not common, but can be used to provide income to life beneficiary

Charitable Remainder Trusts (CRTs)

- Inter vivos trust can qualify as alter ego/joint partner or spousal (consider electing fully or partially out of rollover on transfer of property to trust to be able to utilize tax receipt)
- More commonly a specific discretionary trust (gain is triggered on property transferred to trust, but donation receipt available to offset up to 75% of income plus carryforward)

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Charitable Remainder Trusts (CRTs)

- Do testamentary CRTs still work (i.e. CRT established in will)
- **No!**
- Technical Interpretation 2016-062 584 1 E5 (April 19, 2017) concluded gift of the equitable remainder interest in the trust to the charity was not acquired by estate "on and as a consequence of the death of the taxpayer" so does not qualify for donation when trust funded!
- Need to consider alternate giving mechanism

"Well, we've licked taxes—that just leaves death."

Case Studies

Charitable Donation – Gift in Will

- Regular bequest in will (fixed amount, percentage of residue or formula)
- Deduction available in whatever tax year executor makes donation plus carry back and carry forward
- Could be 10 years total (5 years either side)
- Still will likely want it to be on terminal return
- Elimination of capital gain on donation of marketable securities still applies
- Note – Must be a GRE (or former GRE plus 2 years) for these rules to apply

Charitable Donations - Donation through a LIT

- John and Jane have the following in their estate planning:
  - They leave their non registered assets in a spouse trust for each other - each of their assets include securities with accrued gains
  - John and Jane have RRIF's and TFSA's that they leave to each other
  - On the last death, the assets are left to a charity
  - The spouse trust has been structured to give the trustee discretion to allow the donation at the trust level

Charitable Donations - Donation through a LIT

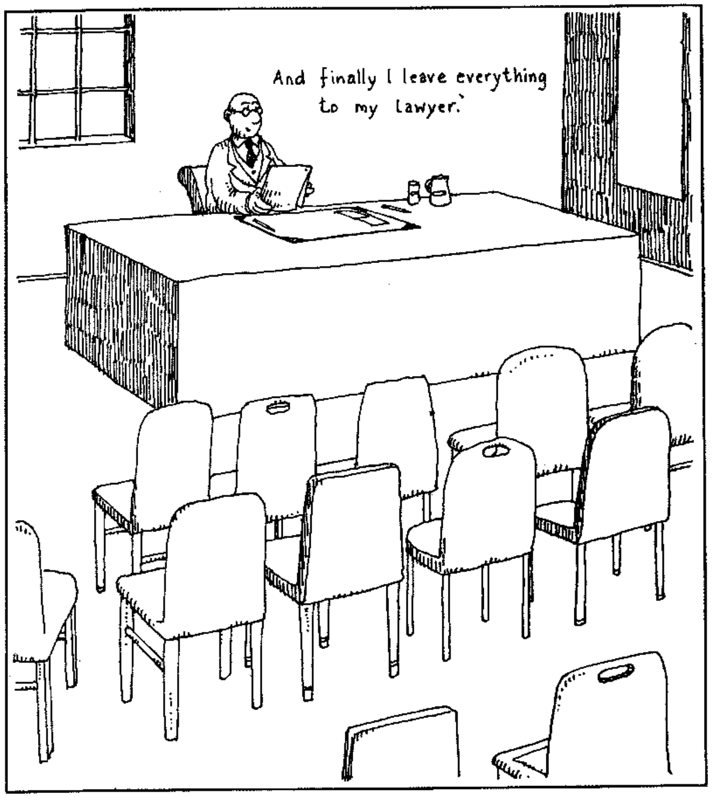
- Plan well set up under old rules
- Now no estate credit as donations not made by a GRE, but LIT can claim against its income
- Possible other options include:
  - Do not use a spousal trust as the donations can be made by the surviving spouse's will and will be used against income in the second spouse’s final return

Will Review

- Ensure will has ability to extend the holding of assets in the estate for up to 3 years to take advantage GRE taxation
- Consider clause similar to this:
    - In their discretion, my executors may continue to hold the assets of my estate in trust in the estate for up to three years after my death before distributing the residue of my estate in accordance with the provisions of this will. This does not prevent my executors from making distributions of capital to the residual beneficiaries of my estate or from partially funding trusts established in this will during those three years.
- Similar provisions could be added to extend spouse trust if used

Trust Review

- Ensure trustees of LIT have <u>discretion</u> to make donations (and give wishes in separate letter of wishes) rather than a direction to donate if want a donation credit


And finally I leave everything
to my lawyer.

Planning Principles

1. Avoid charitable donations through life interest trusts if you can – can you get to the same place in another way?
2. If you must use a life interest trust (because of dependant relief concerns or spousal protection), and the client wishes to make donations, try to effect those outside of the LIT from other assets or sources (i.e. life insurance, RRSP/RRIF, etc.)
3. If the client has capacity, amend documents to reflect planning principles note earlier if needed

Planning Principles

4. Consider utility of existing TTs and possible wind-up
5. Watch out for tainting the GRE and losing marginal rates, estate donation rules and 164(6) carry back
6. Model the results a lot more frequently than may have been done before to ensure that the client's specific scenario is fully analyzed

Conclusion

- Changes created opportunities
- Changes created responsibilities

Questions

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Thank you!

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