Bill C-43 Impacts to Charitable Donation Rules

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Bill C-43 received Royal Assent in December of 2014, ushering in a new era of estate planning with changes to the *Income Tax Act* (the "Tax Act"). Included in the bill were changes which have had a significant effect on post mortem planning relating to charitable donations made on death. Generally these rules increase flexibility in respect of plans which utilize charitable donations. However, the new rules had potentially adverse effects on plans utilizing charitable donations and trusts to which an individual can transfer property on a tax-deferred basis such as spousal trusts, alter ego trusts, joint spousal or common law partner trusts (referred to herein as "life interest trusts"). These concerns led to joint submissions being made to the Department of Finance ("Finance") by the Society of Trust and Estate Practitioners (STEP) Canada, the CBA/CPA Canada Joint Committee on Taxation and the Conference for Advanced Life Underwriting (CALU) outlining substantial issues with the new rules. In November of 2015 Finance issued a letter acknowledging the concerns and indicating willingness to work towards a solution.

Finance has recently published legislative proposals (the "proposed amendments") and explanatory notes which address a number of the concerns raised in the joint submissions.

Rules Currently in Force

The rules introduced in Bill C-43 significantly changed the way in which donations on death are treated for tax purposes. Gifts made by the deceased "by Will", designated gifts, and gifts made by an estate are now all deemed to be made by the estate at the time the property is actually transferred to the charity. The value of a gift is determined at the time of the donation and estates can carry-forward any unused charitable donations for 5 years from the date of death.

Special rules now apply to gifts made by estates that qualify as Graduated Rate Estates ("GREs") at the time of the donation. In such cases, the credit can be claimed:

- by the deceased individual in the year of death or the immediately preceding year,

- by the GRE in the year of the donation or any prior year of the GRE, or
- in any of the next 5 tax years of the estate, provided that it remains in existence.

An estate will qualify as a GRE if:

- no more than 36 months have passed since the date of death,
- the estate is a testamentary trust under the Tax Act,
- the estate designates itself as a GRE in its first tax return that ends after 2015,
- no other estate designates itself as a GRE of the individual, and
- the deceased individual's SIN is provided.

These rules provide enhanced flexibility to maximize the tax credits available to GREs. Exemptions from capital gains for publicly traded securities also apply to gifts made by GREs, resulting in no deemed disposition immediately before death for such securities provided they are subsequently donated to a qualified donee by the individual's GRE. These rules have created a sense of urgency to ensure all charitable gifts are made within 36 months of the date of death, as this access to increased flexibility is currently lost when GRE status is lost. Fortunately, it appears that this tight timeline has been partially addressed in the proposed amendments, as discussed below.

Although these rules have alleviated the issue of unused tax credits in certain situations, some problems with the new legislation exist. For example, gifts made by a life interest trust can no longer be used to shelter the gain formerly triggered in the trust on the death. This is because Bill C-43 also introduced two important changes: first, a tax year end now occurs in the trust at the end of the date of death of the last surviving life beneficiary of a life interest trust, and second, the tax triggered on the deemed disposition of the trust's assets is shifted from the trust to the estate of the deceased life interest beneficiary (subject to the tax authorities assessing the trust under a joint liability provision). Therefore the taxpayer liable for the tax (the beneficiary of the trust) is not the taxpayer making the donation (the trust itself). Further, as a result of the deemed year end on the date of death of the beneficiary, any charitable donation would be made by the trust in a later taxation year of the trust, and the benefit of the donation cannot be carried back to the year of death.

Fortunately, the mismatches created by these rules are being addressed through a number of proposed legislative amendments.

The Proposed Amendments

Attribution of Income to Deceased Beneficiary of Life Interest Trust

The proposed amendments contain important changes to the provisions which attribute income of a life interest trust to a deceased beneficiary in the above described circumstances. First, subject to a limited exception, the income of the life interest trust (and therefore the associated tax liability) will not be shifted to the estate of the life interest beneficiary. Income (and tax) shifting will only occur in the context of a spousal or common law partner trust that arose on and as a consequence of a death before 2017, in circumstances where the trust and the legal representative of the GRE of the life interest beneficiary (i.e. the spouse or common law partner) jointly elect to have the income (and tax) shifting occur. Where such an election is not made, or any of the other

listed conditions are not met, the trust will be liable for the taxes triggered on the deemed disposition.

Carrying Back Charitable Donations in a Life Interest Trust

The proposed amendments also contain provisions which allow charitable donation credits of a life interest trust to be carried back to the previous taxation year in limited circumstances. These amendments, coupled with the elimination of the tax shifting described above, offer a solution to potential mismatches between the tax year in which tax liability arises (the year of death of the last surviving life interest beneficiary) and the next tax year in which the offsetting donation is made.

Under the proposed amendments, a life interest trust would be entitled to carryback a charitable gift to the year of the deemed disposition on the death of the life interest beneficiary (the "particular year"), the gift is made on or before the filing due date of the trust for the particular year and the gifted property was held, or was substituted for property held, prior to the death of the individual which triggered the deemed year-end. Trustees will have a window of time in which they can make charitable donations after the deemed year-end to offset the trust's income for the previous year, which would include any capital gains arising from the deemed disposition of the trust's assets.

Extending Timeline for Making Gifts from a GRE

The new rules providing enhanced flexibility in allocating charitable donations currently apply only to gifts made by a GRE, effectively imposing a 36 month time limit for making charitable gifts out of an estate if flexible allocation is desired. The proposed amendments include changes which would extend the period in which charitable gifts made by an estate would be eligible for flexible allocation to 60 months. This extension will only apply where the estate would otherwise be the GRE of the deceased if not for the 36 month time limit having passed. This extended timeline would also apply to the special rules applicable to gifts of qualified securities, ecological gifts and gifts of cultural property which provide exemptions from capital gains in certain circumstances. Donations made by an individual's former GRE within 60 months of death can be allocated among the taxation year of the estate in which the gift is made or the last two taxation years of the deceased individual (i.e. the year of death and the immediately preceding year). Note that unlike a gift made by a GRE, a gift made between 36 and 60 months of death cannot be carried back to a prior year of the estate or GRE.

The extended timeline for making charitable gifts should alleviate much of the anxiety felt by the estate planning community in regard to the tight timelines which were introduced with the new rules.

Conclusion

The proposed amendments show that Finance has made large strides in remedying the concerns identified by stakeholders. It should be noted the proposed amendments may not be passed in their current form, and Finance is seeking comments on the legislative proposals no later than February 15, 2016. The changes described above may have a significant impact on existing donation planning. Charitable gifting should be reviewed in light of these rules to maximize the available benefits.

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