Planned Giving Instruments: The Trust Spectrum*

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Introduction

This article arises from a request by the Program Committee of the North American Conference on Christian Philanthropy for an update of a previous article in *The Philanthropist,* "Planned Giving Instruments: The Great Circle Route"[1]. I was asked to reflect on some of the planned giving instruments available to charities in Canada and focus on the ones which have the most potential to be developed effectively. While I will occasionally refer to that previous article and update some of the tax changes since it was written, I will concentrate on looking at the largely untapped potential for using charitable trusts in Canada.

Having restricted myself to charitable trusts, I am changing my metaphor from the "Great Circle" to the "Trust Spectrum". The Great Circle Route contemplated the introduction of lifetime planned giving instruments after beginning discussion with a prospective donor by talking about a potential gift in a will. The thesis is that a prospective donor will feel less threatened by a discussion of a testamentary gift as it will not be made until after his or her death. It was recommended that the planned giving officer then introduce a range of planned giving instruments with a detailed explanation of their respective advantages and problems. The objective would be to try to bring the donor to see how much simpler and more tax-effective it would be to make an immediate outright gift. Following the Great Circle Route, the planned giving officer attempts to achieve the objective of getting an immediate cash gift while testing to see if a planned giving instrument will result in a larger gift. I pointed out that following "the Great Circle Route", in many situations it is possible to obtain an immediate gift and then come back and obtain an additional planned gift.

The thesis behind solicitation based on the "Trust Spectrum" is that it should be an inviolable rule that a planned giving officer approach *every* potential donor with the objective of obtaining both an immediate gift and a testamentary gift. An immediate gift is the most desirable result because it is irrevocable and simple. As such, it is at one end of the planned giving spectrum. The other end

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of the spectrum is the will or testamentary gift which is much less attractive because it is deferred, revocable, complex and can usually be attacked under dependants' relief legislation. While both gifts might not be entered into at the same time, they should both always be in the mind of the planned giving officer.

A charitable trust is the most flexible planned giving instrument. It enables a planned giving officer to bridge the two ends of the spectrum by providing a mechanism which gives immediate legally binding effect to a donor's present generous intent while delaying the time when the donor must give up his or her use and enjoyment of, or benefit from, the property to be donated. It is important, however, to remember that not all charitable trusts are equally beneficial to the recipient charity, to know the differences between them, and to understand where they fit on the planned giving spectrum.

Definitions of "Planned Gift"

There is some confusion as to exactly what the term "planned gift" means. I often think of a planned gift as the term which we give to any gift which is so complicated and convoluted by tax and trust considerations that we try to dignify the resulting confusion and complexity by referring to it as "planned". On the other hand, in situations where the transfer of assets to a charity is encumbered by income, life tenancy, and even reversionary interests retained by the donor, we try to mask all the planning that has gone into the transaction and emphasize the word "gift" to maintain that there is a generous intent. However we define a "planned gift", it is impossible to create a planned giving instrument which is free from complexity. The difficulty is that we must combine very complex concepts of trust, charity and estate law with the even more incomprehensible technicalities of tax law and communicate the result without running afoul of the "Keep It Simple Stupid" rule. The challenge is deceptively difficult because it is only possible to explain something complex in very simple terms if we have a sophisticated understanding of the issues involved. In advising donors on planned giving it is necessary to balance concerns about the donor's estate and need for income and security with tax considerations.

It is important to point out that the term "charitable trust" as used in this article is not a trust which the law or the *Income Tax Act* would regard as "charitable". Technically, a "charitable trust" must devote all of the income and capital to charitable purposes. It can be registered with Revenue Canada and be exempt from tax on both income and capital gains. However, the charitable trusts described in this article all have a split interest—a portion of either the capital or income is paid to non-charitable purposes, i.e., the settlor or named beneficiary of the trust. As such they are subject to the same rules of taxation and law as any other trust which has absolutely no charitable component.

Problems With Testamentary Gifts

The conventional starting point for introducing planned giving instruments to potential donors is a chat about testamentary giving and the will. This approach has the advantage of not requiring the timing of the charity's approach to the donor to be tied to any existing campaign and also of not requiring the content of the proposal to be tied to any particular project. In addition to these advantages, a testamentary gift proposal may meet with the least resistance from the donor because the will can be drawn today without having to give anything now. Donors feel good about acting on their intentions but also know that the opportunity remains to change their minds and revoke or alter their gifts.

Unfortunately the very characteristics of testamentary gifts that make them attractive to donors are those that present problems from a charity's perspective. For example, the planned giving officer and the charity are incurring significant costs in planning, drafting, and executing a will; the value of the gift is reduced by inflation during the long time period between the writing of the will and the death of the donor; and until the donor dies, the charity receives no return on its investment.

Another problem is dependants' relief legislation which allows relatives and dependants to attack a will by alleging that too much was given to charity and to ask the courts to give more to members of the family. Every province and state has legislation such as the *Wills Variation Act* in British Columbia which allows dependants (particularly spouses and children) to petition the court to set aside charitable bequests and other testamentary dispositions if there has not been adequate provision for them. In many jurisdictions the law allows even wider classes of dependants and relatives to make claims against estates. Charitable bequests are particularly vulnerable to this type of attack.

This is an increasing problem as more people become more sophisticated about their legal entitlement to challenge wills. Charities are part of the problem because they very seldom defend their charitable bequests against attacks from dependants. Rather than face adverse publicity, they settle out of court. Consequently it becomes increasingly easy and profitable for dependants simply to file a challenge, no matter how spurious, knowing they will not have to pursue it seriously because the charity will make a generous offer to avoid going to court. The charity's interest in avoiding litigation is obvious; what is less obvious is that generous and easy settlements contribute to the number of challenges which are taking place. Further, donors anticipating a challenge which they believe the charity will not oppose, frequently decide to spare the estate and the family the expense and embarrassment of a challenge and eliminate the charitable bequest before they die.

Another problem with testamentary giving is that it is impossible to maintain privacy in the probate process. The will, the value of the estate's assets, and the distribution of the estate all become a matter of public record once they are filed with the court when the will is probated. This is an issue that few people consider before drawing a will. When the public nature of the probate process *is* made known to them, they frequently find the privacy offered by a lifetime trust is a very attractive alternative to a bequest.

Public access to probate documents is not the only privacy issue concerning many donors. They also worry about how much the charity will learn about their estates. If a charity is named as a beneficiary in a will, that charity is entitled to a copy of the entire will and, in many circumstance, must agree to the statement of accounts of the estate. This means that a charity becomes privy to much more information about the donor's assets, wealth, and family distributions than the donor may want it to have. This disclosure is so distasteful to some donors that they refuse to make gifts to charities by will.

"Testamentary" Giving Through Charitable Trusts

With the disadvantages of testamentary giving by means of the will in mind, it is time to explore the advantages of charitable remainder trusts. A charitable remainder trust can provide privacy by avoiding the disclosure which is necessary for probate. More importantly, an irrevocable charitable remainder trust, settled with an immediate gift, will probably not be considered an asset of the estate for purposes of a dependant's relief claim. If it is irrevocable it also relieves the charity's apprehension that donors may subsequently change their minds about making the gifts.

Charitable trusts provide the most effective method of enabling the donor and the charity to circumvent the problems of testamentary giving without the donor having to make an immediate outright gift. While it is difficult to explain the legal principles which govern a trust and it is a demanding legal instrument to draft, utilizing a trust is worth the extra effort because it is such an amazingly flexible instrument. If you can anticipate a problem, it is most likely going to be possible to draft a trust which solves the problem.

Since charitable trusts are mechanisms for making immediate irrevocable gifts, planned giving officers must approach donors with the same sensitivity and concern they would display in seeking an immediate cash gift or a testamentary bequest. As the most attractive end of the giving spectrum (an immediate gift) has presumably been rejected by the donor and the other end of the giving spectrum (a deferred testamentary gift) is being considered, introducing the suggestion of a charitable trust gives the planned giving officer an opportunity to obtain a gift in the middle of the spectrum. The skill and flexibility employed will determine how close to either end of the spectrum the final decision is located. As we shall see, not all charitable trusts are equally beneficial to the charity.

At the outset, it is important that the planned giving officer correctly analyze the relative wealth and income needs of the potential donor before determining what is the best planned giving instrument to recommend. The donor constituency is divided into many different groupings based on factors such as age, wealth, income, dependants, and philosophical commitment to charitable giving. There are two primary motivations in making a planned gift which must be distinguished when advising on planned giving instruments. Assuming that donors making a planned gift either began by considering a testamentary gift or have rejected an immediate gift and are considering a testamentary gift as an alternative, they are considering giving assets from their estates. The question then becomes whether they are giving assets as an advancement of their testamentary gifts or as a means of depleting their estates. These two approaches to giving reflect very different concerns and interests and consequently must be handled very differently.

The Estate Advancement Gift

If donors want to give their estates to a charity but cannot do so immediately because of income and security needs, a charitable trust allows them immediately and effectively to complete the legal commitment to donate their estates while deferring the actual transfer of the use and enjoyment of their assets until their deaths. I consider this an Estate Advancement Gift. Donors are primarily motivated by the desire to make a gift to a particular charity, but prudence dictates that they should not complete the entire gift immediately. Donors therefore use a charitable trust to advance their gifts of legal entitlement to a testamentary bequest even if they cannot afford to advance the asset itself until after their deaths. Depending on the skill of the planned giving officer and the circumstances of the donor, this advancement may or may not be irrevocable. The test is whether the charitable trust and the property settled on it are made irrevocable.

The most common estate advancement involves potential donors who are not wealthy but want to give to charity a lot of money relative to what they own. The priority for these donors must be conservation of their estates while they remain alive. Only legal entitlement to the estate should be advanced; not the estate itself. Donors in this situation are usually elderly widows, widowers or single people who have significant assets and want them all to got to the charity after their deaths. The charitable trust must produce the necessary cash flow to meet the donors' income needs and provide enough security to protect them against catastrophic financial reversal or serious illness which may deplete their estates. If these donors transfer assets to charity it must be done in ways which conserve the capital of their estates and meet their needs for continuing income.

The Estate Depletion Gift

A second motivation for planned giving is found among those who are extremely wealthy and are considering actually depleting the capital of their estates by charitable gifting. In this situation the planned giving officer must give priority to reducing taxes in order to preserve and conserve the donors' estates for the charity rather than to protect the donors' income and security needs while they remain alive. Elderly widows, widowers or single people who have significant assets and want them all to go to charity after their deaths often make up this group as well. The difference is that these donors have sufficient assets to make large charitable gifts while still meeting their own income requirements. The charitable trust is used to achieve tax efficiency by shifting the tax liability for capital gains to the charity so the gift is not reduced by taxes. The charitable trust also reduces the cost of probate and the risk that dependants may challenge the will. These donors should transfer assets to charity in ways which are primarily designed to protect the charity's interest in the capital of the estate by reducing and frustrating encroachments on the gift by the government and greedy relatives.

It is surprising how often a planned giving officer encounters instances where children are richer than their parents because 10 or 15 years earlier there had been an estate freeze. The freeze has usually been entered into in a period when inflation was low and the parents thought that three or five million dollars paying eight per cent interest would be all the money they would ever need. Consequently through sophisticated tax-planning techniques, they passed the future growth of their estates to their children. Now the children are often worth several times as much as the parents, who are often interested in passing most of what remains of their estates to charity.

There are a variety of other situations where the wealthy donor can be interested in depleting his or her estate by giving massive amounts to charity without considering the children's interest. In some cases there has been a breakdown in the family relationship because the parents were spending so much time building the estate they did not pay any attention to the children and gradually became estranged. In other cases the children have become spoiled, demanding, and unappreciative. Other negative situations include bitter or multiple divorces or mistrust of spendthrift children. In these cases the donor is doing estate planning and using planned giving instruments not out of philanthropy, but to keep the estate away from a former spouse or grasping children.

Nevertheless, these are exceptional circumstances and the vast majority of gifts are made because successful people want to put something back into the community which created their wealth. Many very wealthy people—particularly those with first-generation wealth which they have earned themselves—genuinely believe that it could harm their children to give them too much money. They are quite happy to give their children a house and two or three million dollars, but fear that more would sap the children's energy and ambition. Charity they feel produces both a good result in the community and a lasting legacy.

It is very important that planned giving officers analyze donors so that the correct approach is adopted to meet the specific needs of each. The primary way to vary the approach to different groups of donors is by the type of charitable trust which is introduced into the giving proposal.

Never Forget the Will

It should be an inviolable rule of planned giving solicitation that the planned giving officer approach every potential donor with the objective of getting both an immediate gift and a testamentary gift. Adopting the philosophy of the Great Circle Route, sophisticated and complicated planned giving instruments should never become an end in themselves but only a secondary approach to achieve a deferred or restricted gift when it is clear that an immediate gift is not possible or would be much smaller than a planned gift. Similarly, achieving an immediate or planned gift is no reason for a planned giving officer to ignore the potential for a testamentary gift.

It is a matter of timing and sensitivity as to when it is appropriate to discuss testamentary dispositions with a donor. No planning for a testamentary gift can be done without knowing what is in the donor's will. (Always remember there is no shame or blame attached to exclusion from the will of a donor who has been generous to the charity during his or her lifetime.) Moreover, it can be greedy and exploitive to badger loyal donors into making testamentary gifts with which they are not comfortable. A planned giving officer should never forget, however, that a refusal is not necessarily final and donors' estate plans are never complete until they are dead.

It is traditional to think of a potential testamentary gift as the entry point for a planned giving officer to introduce the donor to a variety of planned giving instruments, particularly charitable trusts. Certainly the Great Circle Route was based on the assumption that planned giving instruments would be introduced after discussion of some of the problems arising from a gift in a will. Similarly, to this point in this article the presumption has been that trusts are being introduced when the donor has moved to a consideration of testamentary giving. However, while that may be the easiest point of entry for introducing a charitable trust, it fails to take advantage of the opportunities created in a capital or annual campaign.

If we are going to see an increase in the number of times that a charitable trust is successfully utilized in planned giving in Canada, it is important to introduce it into a greater variety of giving opportunities. One of the reasons that so few charitable trusts are written is that so few charities have developed and marketed significant planned giving or testamentary giving programs. It is therefore necessary for the planned giving officer who perceives the benefit of such trusts to identify and act upon the opportunities to introduce the idea into situations encountered in a capital or annual campaign as well as just into the discussion of a will.

(From this point we will operate on the assumption that the potential donor is primarily considering—and usually rejecting—a large immediate gift in a capital or annual campaign.)

It is one of the great disciplines of planned giving to conduct all negotiations and contact with donors with the knowledge that you also want to be able to talk to them about their wills. This long-term perspective should distinguish the successful planned giving officer from the successful capital campaign or annual drive officer whose measure of success is judged on the basis of donor commitments in any given annual or capital campaign. Rather than being a sign of greed, keeping a testamentary gift in mind is one method of guarding against the over-reaching short-term greed which can result when a solicitor considers only an immediate gift towards the current campaign. A planned giving officer who never forgets that an existing testamentary gift can be revoked without the charity's knowledge and remembers that any will can be rewritten to include the charity, will treat the donor with greater consideration and sensitivity. That sensitivity is often the key factory in leading a donor to add a testamentary gift to a legacy of lifetime giving.

Successful planned giving officers must develop different mindsets to that of annual or campaign giving officers. They should be as interested in gauging a donor's loyalty to the charity as they are in gauging the donor's interest in the immediate proposal or current campaign. The primary objective is not to meet any gift quota for the current capital campaign or annual drive. Rather, planned giving officers have a time perspective which encompasses the lifetime of the donor and considers the next generation. They present current funding projects with the measured and balanced salesmanship of a respected broker promoting current stock offerings to a long-term valued client rather than with the hyperbole of a junk bond salesman flogging the latest hot issue. If the donor does not want to participate in the current campaign, the planned giving officer must determine whether that reluctance is based on financial constraints or lack of enthusiasm for the proposed project.

If the problem is financial constraints, the planned giving officer must decide whether they arise from cash flow problems or from inadequate financial resources. If the problem is cash flow, the planned giving officer should consider whether sophisticated tax planning will ease the cost of the gift or whether it is necessary to introduce a planned giving instrument which will result in the charity receiving the financial benefit at some deferred time. The purpose of a planned giving instrument is to lock in a donor's present donative intent when the nature of the donor's assets and the scope of current liabilities do not permit an immediate gift. A charitable trust allows the maximum flexibility in designing a charity's entitlement to a future gift which is effectively tailored to the donor's particular circumstances. Unlike a pledge or testamentary intention to give, a charitable trust is binding and enforceable at law.

If the donor's reluctance to participate in the current campaign is based on a lack of enthusiasm for the proposed project, the planned giving officer downplays the particular project and promotes the charity as an institution, listening carefully to the aspects of the proposal which the donor has found unappealing and considering alternative gifting opportunities which do not present those problems. A successful planned giving officer does not restrict a donor's gifting opportunities to those set out in the case statement or current campaign. If the gift is of significant magnitude, donors can even fund projects of their own choosing which are both important to the charity and satisfying to the donors.

When donors give by means of a charitable trust, it is also more likely that the gift will be unrestricted as to use than is the case for an immediate gift resulting from a campaign solicitation. Frequently, an unrestricted gift is more valuable to a charity in the long run than simply fulfilling a campaign objective. One of the more subtle challenges of planned giving solicitation arises when a donor's interest is aroused by a special project but the donor feels he or she cannot make an immediate gift. The project obviously cannot wait for a deferred gift. The challenge for the planned giving officer is to lead the donor away from an immediate designated gift to a deferred gift with a reduction or elimination of restrictions on its use.

Problems With Charitable Trusts

Planned giving officers in Canada look at the huge number of charitable remainder trusts which are written in the United States and wonder why so few exist in Canada. There are some significant and fundamental differences in tax laws which offer a partial explanation. The settling of, or putting money into, a charitable trust in Canada, unlike in the United States, is a taxable disposition. A Canadian settlor or donor triggers capital gains taxes immediately when assets are transferred into a charitable trust. The problem arises because the settlor receives no money back from the trust (because the assets were not sold) and therefore does not have the cash to pay taxes on those capital gains.

Thus a charitable trust is not very attractive unless the donor has cash or assets with a high cost base which do not trigger taxes when the charitable trust is settled. Since many people only consider a charitable trust when, or because, they do not have cash, a charitable trust is not a solution if the asset has appreciated significantly in value. For example, if the asset under consideration is a principal residence, which is not subject to capital gains taxes, a charitable remainder trust may be appropriate. However, in many other situations, unfortunately, this tax problem is not surmountable and, therefore, there are fewer charitable trusts in Canada than in the United States. In Canada, settling assets into a charitable trust is a taxable disposition whether the charitable trust is revocable or irrevocable.

An additional problem in Canada is that subsection 75(2) of the *Income Tax Act* attributes any income or loss and any capital gain or loss from a revocable trust back to the settlor whether or not the settlor actually received the income or the capital gain. This problem was detailed in the Great Circle Route[2] and the proposed solution to the income attribution problem was to make the charitable trust irrevocable. The charity benefits because it becomes the beneficiary of an irrevocable charitable trust rather than a revocable charitable trust. An irrevocable trust is also much safer from an attack under dependants' relief legislation.

The problem with an irrevocable charitable trust is that the donor may not be prepared to make an irrevocable gift. The solution to the irrevocable versus revocable problem proposed in the Great Circle Route[3] was to make the charitable trust irrevocable but to settle it with only a nominal amount of money. The settlor would then proceed to loan a significant amount of money to the irrevocable charitable trust on the basis that it would not pay any interest to the settlor. Alternatively, the loan would stipulate a fair market interest rate but interest would be waived unless it was actually needed by the settlor. In 1985 when the Great Circle Route was published that was acceptable under the provisions of the *Income Tax Act.*

Unfortunately, subsection 56(4.1) was added to the *Income Tax Act* in 1988 as an anti-avoidance provision with the result that there is now income attribution when an interest-free loan is made to any trust. The *Income Tax Act's* definition of an individual[4] excludes a corporation but not a trust. Therefore it is still possible to avoid income attribution when making an interest-free loan directly to an incorporated charity but income attribution applies if an interest-free loan is made to a registered charity which is established as a trust or an unincorporated association.

Spectrum of Charitable Trusts

A charitable trust is very flexible and can be tailored to address the particular needs and opportunities presented by an individual donor. It is important, however, to recognize that not all charitable trusts are equally beneficial to the charity. Understanding the features of different types of charitable trusts and where they are most likely to be utilized will assist the planned giving officer in introducing the most appropriate solution. The planned giving officer should not be trying to sell the charitable trust itself but simply using it as a vehicle to enable a donor facing certain economic or tax restraints to give immediate effect to a donative intent.

From a charity's perspective the usefulness of charitable trusts in the spectrum of planned giving instruments is (in descending order): Asset-Retaining Irrevocable Charitable Remainder Trust, Irrevocable Charitable Phoenix Trust, Income-Disbursing Irrevocable Charitable Remainder Trust, Revocable Charitable Remainder Trust, Irrevocable Capital Payment Trust, Irrevocable Charitable Phantom Trust, and the Irrevocable Charitable Residue Trust.

Asset-Retaining Irrevocable Charitable Remainder Trust

The most common and conventional charitable trust is the Irrevocable Charitable Remainder Trust. It is used when donors want to make an estate advancement gift to a charity but need to hold on to the assets to protect their income and security needs. The most common situation arises when donors want to give the matrimonial home and principal residence but need to live in it for the rest of their lives. Legal title to the residence passes to the trustee and the donor continues to have the use and enjoyment of the home. The charity receives an immediate vested entitlement to a deferred interest in the residence. It is to be hoped the house will increase in value and the charity will receive all of the increase. Also, the terms of the trust should be such that the settlor pays all or most of the operating costs so the charity need not put out any cash to maintain the asset.

The Asset-Retaining Irrevocable Charitable Remainder Trust is preferable to a testamentary gift because it is irrevocable and is not a gift from a will so cannot be challenged under dependants' relief legislation. Further, it is not subject to the delays of probate and is completely private as it need not be mentioned in the will. As the asset involved is usually the principal residence, there is no tax on capital gains when it is settled on the trust.

The problems with the Asset-Retaining Irrevocable Charitable Remainder Trust are practical rather than legal. It becomes important to define who is responsible for minor repairs, structural repairs, property taxes and insurance, etc. This gift has the possibility of incurring significant cost outlays to maintain the asset which can result in souring the relationship with the donor should there be any disagreement as to what is reasonable in the circumstances.

Irrevocable Charitable Phoenix Trust

As explained previously, a settlor incurs capital gains taxes when assets are settled into a trust. This can be an impediment both to an estate advancement gift and an estate depletion gift when the assets have increased in value. One solution which I have used is to settle an Irrevocable Charitable Phoenix Trust with $10 upon the terms that all additional capital contributions and any income earned be paid to a named charity in the last week of December in each year. The settlor is a trustee, but preferably not the sole trustee, for life. The named charity replaces the settlor as a trustee upon his or her death.

After settling the trust with $10, the settlor then delivers to the trustees of the Irrevocable Charitable Phoenix Trust a properly executed promissory note for $1,000,000 which is due and payable six months after the settlor's death with interest payable from the due date at the rate of prime plus one per cent. The result is that the donor has made an irrevocable $1,000,000 gift which does not require liquidity and therefore does not trigger any capital gains taxes. Not only does this gift of a promissory note avoid probate and dependants' relief challenges, it is more secure than a gift in the will. This promissory note is a debt of the estate and therefore ranks ahead of any pecuniary legacies or gifts out of the residue of the estate. Care must be taken to make sure that the terms of the promissory note are drafted in such a way as to avoid any allegation that it is a testamentary disposition. Further, to strengthen the settlor's executor's ability to resist any litigation attempts to set this promissory note aside, the delivery of the promissory note to the trustees should be by a legal covenant and deed of gift or there should be consideration given for the promissory note.

The promissory note given to the Irrevocable Charitable Phoenix Trust also avoids the income attribution problems posed by subsection 56(4.1) because no property is loaned to the trust prior to interest being charged. The loan itself is deferred, which is not the case with the interest-free loans described previously. The Irrevocable Charitable Phoenix Trust is completely private and need not be mentioned in the will. The original $10 is usually placed in a trust account (for my clients, in my law office) which earns no interest for the trust so there is no administrative work. Further, as there is no need to make annual payments to the charity, the settlor need not even alert the charity to the trust's existence. The Irrevocable Charitable Phoenix Trust simply lies silent and unknown until the death of the settlor.

The Irrevocable Charitable Trust does present some problems with regard to the most tax-efficient way to treat the gift of the $1,000,000. The most correct technical interpretation of the legislation would be to treat the gift as being completed at the time the promissory note is delivered to the Irrevocable Charitable Phoenix Trust and to issue a receipt for the present value of $1,000,000 based on the donor's life expectancy. It would be necessary to notify the charity and secure its co-operation in order to achieve that result.

If the charity is brought into the process at the time of the gift it is possible to eliminate the Irrevocable Charitable Phoenix Trust and have the promissory note given directly to the charity. Again, if litigation is contemplated, be sure that there is a deed of gift and covenant or consideration. The charity has then obtained an immediate irrevocable gift of a deferred interest with all of the advantages of avoiding a testamentary gift. As a promissory note clearly falls within the *Income Tax Act* definition of "property"[5] the donor is entitled to receive a charitable donation receipt and obtain immediate tax relief for the present fair market value of the gift.[6] As the donor has received this donation receipt without actually liquidating any assets and triggering capital gains taxes, the charity must be careful to determine what level of security it may need for the promissory note. The greater the security available to guarantee payment of the promissory note, the greater will be its fair market value.

The planned giving officer can propose a promissory note payable after the donor's death in preference to a testamentary gift if it is an estate advancement gift. If it is an estate depletion gift the donor will probably prefer to retain an Irrevocable Charitable Phoenix Trust drafted with some discretion as to which charities can be selected as beneficiaries of the charitable trust.

Income-Disbursing Irrevocable Charitable Remainder Trust

If the donor has cash or assets which have not appreciated greatly in value, it is possible to use the Income-Disbursing Irrevocable Charitable Remainder Trust. This is usually an estate advancement gift where the settlor needs to receive all of the income. Since all income is being paid to the settlor, it is appropriate that the income is taxed in his or her hands so there is no income attribution problem. The charity finds the Income-Disbursing Irrevocable Charitable Remainder Trust less attractive than the Asset-Retaining Irrevocable Charitable Remainder Trust to the extent that the capital assets are not appreciating in value and the charity is receiving no income. It can be made more attractive by modifying the investment policy of the charitable trust to increase the assets which are invested in equity growth investments rather than investments which only produce income.

Like the previously described charitable trusts, the Income-Disbursing Irrevocable Charitable Remainder Trust benefits from the fact that it is not a testamentary gift so avoids probate and dependants' relief challenges and achieves privacy. As it is irrevocable, the charity can rest assured that there will be a gift after the donor's death.

Irrevocable Charitable Capital Payment Trust

If a trust can be drafted to pay income to the charity and pay capital to the settlor it has achieved maximum tax efficiency. The reason is that income is taxed in the hands of the charity (which is tax-exempt) and capital payments are received free of tax by beneficiaries. In an estate depletion gift, it can make sense to draft a trust which removes assets from a settlor's estate if the settlor can receive tax-free capital payments. This trust and the legal problems which it presents are more fully described in the Great Circle Route[7]. The charity's benefit is reduced to the income earned on the capital during the settlor's lifetime and any capital remaining at the time of the settlor's death.

Revocable Charitable Remainder Trust

If donors who need income are contemplating an estate advancement gift and have assets which trigger no capital gains, it is not always possible to convince them to settle assets irrevocably into an Income-Disbursing Irrevocable Charitable Remainder Trust. In these situations it is sometimes necessary to settle for a Revocable Charitable Remainder Trust. This charitable trust suffers from the disadvantage of not being irrevocable but at least it avoids probate and dependants' relief challenges in most jurisdictions, and is private. There is also a much greater chance that the charity will be advised if it is revoked than there is when a donor is simply deleting a testamentary gift from a will. In addition, if the charity is the trustee, it must necessarily be party to any revocation.

Irrevocable Charitable Phantom Trust

The Irrevocable Charitable Phantom Trust, like the Irrevocable Charitable Phoenix Trust, is settled with only $10. The settlor is usually the only trustee while he or she is alive and the executors of the will are frequently named the trustees after the settlor's death. The beneficiary of both the capital and income of the trust is a named charity, although the trustees may be given discretion to select any charity. More importantly, the settlor gives the trustee the absolute discretion to pay out all of the capital of the Irrevocable Charitable Phantom Trust at any time during the settlor's lifetime.

The trustee exercises this discretion to pay out the capital whenever there is a change in the named beneficiary of the Irrevocable Charitable Phantom Trust. For the cost of $10 the settlor has achieved revocability of an irrevocable trust. When the $10 is paid out, the Irrevocable Charitable Phantom Trust disappears like a phantom. With the magic of word processing, and for the price of another $10 settled into a new trust which names the beneficiaries the settlor currently prefers, a new Irrevocable Charitable Phantom Trust can be created. This process can be repeated as necessary.

Unlike the Irrevocable Charitable Phoenix Trust, the Irrevocable Charitable Phantom Trust is not settled with a promissory note but funded with a gift from the settlor's will. As long as the trust is irrevocable it can be the recipient of a bequest from a pour-over will. The will simply needs to name the Irrevocable Charitable Phantom Trust and state how much money should be gifted to it. This is a testamentary gift so it is subject to probate and a dependants' relief challenge. The settlor has achieved some privacy, however, in that, while the name of the Irrevocable Charitable Phantom Trust and the amount gifted to it are disclosed in the will, the terms of the trust and the identity of its beneficiary need not be disclosed.

The Irrevocable Charitable Phantom Trust is therefore much more attractive to the donor than to the charity since the donor is maintaining the flexibility to change both the beneficiary of the trust (by paying out the capital) and the amount of the gift (by changing the gift in the will). The advantage to the charity is that if donors are interested enough to go to the trouble of creating an Irrevocable Charitable Phantom Trust they would seem to be demonstrating a firm intention to give and it is reasonable to expect that a gift will indeed follow in due course.

Irrevocable Charitable Residue Trust

The Irrevocable Charitable Residue Trust is the name which I give to a trust where all that the charity receives is a "gift-over" or whatever residue is left after the non-charitable beneficiaries have received their legacies. It is used most often in the sort of trust which gives "$10,000 to my sister Mary if she should survive me". If the settlor has a series of such gifts amounting to a total of $100,000, he or she might choose to settle the trust with $110,000 to cover all legal, tracing and trustees' fees without encroaching on the $100,000 needed for distribution. Naming a charity as the residual beneficiary solves the problem of distributing any amount left over after the costs of the trust have been paid without getting the other beneficiaries involved in the process of passing the accounts and receiving fractionally larger distributions. This formula simplifies the trustees' job by keeping the other beneficiaries away from concerns about the costs of administering the Irrevocable Charitable Residue Trust. At the same time, the fact that a charity has to approve the final accounts because it is the beneficiary of the residue is a strong incentive for the trustees to keep costs down.

The charity is not likely to receive much money from such an Irrevocable Charitable Residue Trust but it has very little work to do for the amount it does receive. The real potential for the charity is receiving the $10,000 if "sister Mary" does not survive the settlor. Depending on the terms of the trust and the age of the settlor, the charity can receive a significant amount of money in this way. It will depend on the settlor's liquidity and commitment to making a gift whether the charity also receives all of the interest earned on the capital of the trust. In estate depletion situations where the Irrevocable Charitable Residue Trust is funded during the lifetime of the settlor and the settlor does not require the income, it is tax-efficient and simple to have all of the income earned paid out to the charity before the end of each tax year. If the Irrevocable Charitable Residue Trust is only settled with $10 and funded with a pour-over gift from the will, this benefit is not available to the charity.

Problems With Charitable Trusts

We have seen that using a charitable trust is an effective method of dealing with liquidity problems, avoiding probate and dependants' relief challenges, and giving donors privacy with regard to their intentions. A charitable trust is probably the best vehicle to accomplish either an estate advancement gift or an estate depletion gift when a donor does not wish to make an absolute immediate gift. Unfortunately, a charitable trust is not likely to provide the most effective tax reduction by utilizing the value of the tax credit or deduction arising from the gift. There is great uncertainty in Canada about the acceptable rate to be used in calculating the present value of a remainder interest of a charitable trust. However, if the settlor is reasonably young and life expectancy is more than 10 years, the present value of the remainder interest is so small that it does not matter how it is calculated.

The most effective way to maximize the value and utilization of a charitable credit or deduction is through an immediate gift. The donor then benefits immediately from any tax reduction and has another five years to carry forward any excess tax credit in the receipt. This is much better than waiting until the donor's death before triggering tax relief. Further, while a gift in a will can be carried back for one year, it cannot be carried forward and so frequently the full value of the tax relief can never be realized.

Conclusion

It will become increasingly important for planned giving officers in Canada to understand the distinguishing features of different charitable trusts and be able to introduce the appropriate charitable trust into proposals to donors.

One of the dangers of planned giving arises when a planned giving officer sees two fact patterns that look similar and tries to do the same thing twice without understanding the subtle differences in liquidity or donative intent which would recommend one choice over another. In situations where the planned giving officer does not have the level of experience or expertise to fully understand how to select the most appropriate planned giving instrument I think it is much more beneficial for the planned giving officer to function as a bird dog by locating situations where a charitable trust is likely to be helpful. Someone with more expertise can then be brought in to recommend what form the charitable trust should take. During the process of investigation it may be possible to convince the prospective donor that the complications and tax inefficiencies of any charitable trust make an immediate gift the most desirable course. The problem is that the ability to make a convincing case depends significantly on the technical knowledge of the planned giving officer.

It is critically important to be able to generate some confidence in the technical tax and legal advice provided by the charity either directly through its planned giving officer or indirectly through the professional resources that it introduces to the donor. If donors are rich they will have lawyers and accountants who have spent decades advising them how to accumulate wealth and will articulate every possible reason why they should not give any of it away. It is very difficult for a charity to prevail against such professional advisers if its representatives lack experience and professional credentials.

FOOTNOTES

1. (1985),5 *Philanthrop.* No.2, p.3.
2. *Ibid.*, pp.7–9.
3. *Ibid.*, p.11.
4. Subsection 248(1).
5. *Ibid.*
6. According to *Income Tax Act* Regulation 3501 (1) (h) (ii) the amount on the official receipt should be "where the donation is a gift of property other than cash, the amount that is the fair market value of the property at the time that the gift was made".
7. *Supra*, footnote 1, pp. 15–17.