Comparison of the Tax Treatment of Charitable Remainder Trusts in Canada and the United States

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I. What is a Charitable Remainder Trust?

Charitable remainder trusts are not new but although they have been used in the United States for a number of years,[1] they have only recently begun to generate interest in Canada.[2] Over the past years, the planned giving sector has promoted aggressively the use of charitable remainder trusts as a means by which donors can make gifts to registered charities while continuing to benefit from the income generated by the property transferred to the trust.

A charitable remainder trust is essentially an irrevocable trust that requires the trustee to distribute to the donor or other noncharitable beneficiaries, until the death of the last of them, the income of the trust. When all interests of the noncharitable beneficiaries terminate, the property in the trust is distributed to one or more designated charities. Unlike the United States' *Internal Revenue Code of 1986* (the *"Code"*), there are no provisions in the *Income Tax Act*[3] setting out the rules applicable to charitable remainder trusts in Canada. Revenue Canada's administrative position with respect to such trusts is set out in *Interpretation Bulletin* IT-226R, which discusses gifts of equitable or capital interest in trusts made payable to charitable organizations.[4] This *Bulletin* states, among other things, that a gift of an equitable interest in a trust to a registered charity may qualify for a nonrefundable federal tax credit if it is donated by an individual, or as a deduction if it is donated by a corporation.[5]

1. *The Canadian Model*

According to the *Bulletin*, an equitable interest in a trust is created upon the transfer of any property to a trust with the requirement that the property be distributed to a beneficiary at some future date (i.e., when an income interest of another person ends).[6] If all of the following requirements are satisfied at the time of the transfer to the trust, an *inter vivos* gift of an equitable interest in the trust is considered to have been made at that time.[7]

(a) There must be a transfer of property voluntarily given with no expectation of right, privilege, material benefit or advantage to the donor or a person designated by the donor.[8]

(b) The property must vest with the recipient organization at the time of transfer, i.e., (i) the person or persons entitled to the gift must be in existence and ascertained, (ii) the size of the beneficiaries' interests must be ascertained, and (iii) any conditions attached to the gift must be satisfied.

(c) The transfer must be irrevocable.

(d) It must be evident that the recipient organization will eventually receive full ownership and possession of the property transferred.

As shown by *Interpretation Bulletin* IT-226R, Revenue Canada has sanctioned the use of charitable remainder trusts for the purposes of making a donation to a charity. However, the *Bulletin* does not contain a complete set of rules regarding the tax implications of such trusts.

2. *The American Model*

As indicated, in the United States, the tax rules applicable to charitable remainder trusts are contained in the *Code*. Two types of charitable remainder trusts are defined by Section 664: the charitable remainder annuity trust and the charitable remainder unitrust. Section 664(d)(1) defines a charitable remainder annuity trust as a trust from which a certain sum, based on a stated percentage of the trust's initial assets, is to be paid to the income beneficiary or beneficiaries, not less often than annually. The stated percentage must be equal to at least five per cent of the initial net fair market value of the trust. The payments must be made for either a term of years (limited to a maximum of 20 years) or for the life or lives of the income beneficiaries. Upon the expiration of the term of years or the death of the income beneficiaries, as the case may be, the remainder of the trust's assets must be paid to, or held in trust for the benefit of, a charitable organization.

A charitable remainder unitrust is defined by Section 664(d)(2) of the *Code* as a trust from which an amount equal to a fixed percentage of the net fair market value of the assets of the trust, valued annually, is to be paid to the income beneficiary or beneficiaries of the unitrust, at least annually. The amount required to be paid must be equal to at least five per cent of the net fair market value of the assets of the trust, and must be paid for either a term of years, not to exceed 20 years, or for the life or lives of the beneficiaries entitled to receive the unitrust amount.

The charitable remainder annuity trust is different from the charitable remainder unitrust in the following respects:

1. The charitable annuity trust provides the income beneficiary with a fixed annuity, whereas the charitable remainder unitrust provides

the income beneficiary with a unitrust payment which may vary from year to year based on the valuation of the trust's assets.

2. Section 664(d)(3)(A) of the *Code* provides that a charitable remainder unitrust may permit the trustee to pay the beneficiary entitled to receive the unitrust amount, in any year, an amount equal to the lesser of the designated unitrust amount or all of the income of the unitrust.[9] This option is not available for payments from an annuity trust.

3. Unlike the charitable annuity trust, the charitable remainder unitrust can accept additional contributions after its formation.

Although the definitions of charitable remainder trust in the *Code* are more specific and restrictive than the description for such trusts set out in *Interpretation Bulletin* IT-226R, Canadian and American charitable remainder trusts share some of the same attributes, i.e., both are trusts created for the benefit of a charity, the income of which is payable to the donors or other beneficiaries for life, with the remainder upon death being distributed to the charity.

II. The Tax Characteristics of Charitable Remainder Trusts

1. *The Tax Consequences to the Settlor of the Trust*

Under United States income taxation rules, where an individual donates property that has appreciated, there are no adverse tax consequences, since the "appreciation is not regarded as realized by virtue of the gift".[10] The *Code* provides that in such circumstances the donor's cost base is carried over to the beneficiary of the gift, with the result that the beneficiary is responsible for any appreciation in value that took place while the property was owned by the donor, in addition to any further appreciation from the date of the gift.[11] Where the appreciated property is donated to a charity or transferred to a charitable remainder trust for the benefit of a charity, the donor enjoys a double benefit, namely, a charitable donation deduction[12] and no realization of the appreciation in the property.[13] As a result, donors are generally better off donating appreciated property than making equivalent gifts in cash.[14]

The tax consequences of transferring appreciated property to a charitable remainder trust are not as clear under Canadian income tax rules. Revenue Canada has recently revisited[15] the question of whether a transfer of property to a trust where an income interest under the trust is acquired by the transferor and the remainder interest goes to someone else, is a disposition. The Department now takes the position that, in these circumstances, the entire property has been disposed of at this fair market value. Accordingly, in the absence of a relieving provision, the transfer of property to a charitable remainder trust

will constitute a taxable disposition. Although the *Act* contains a relieving provision that applies to gifts of capital property, (subsection 118.1(6)), whether this provision applies to charitable remainder trusts is debatable.[16]

Subsection 118.1(6) of the *Act* sets out rules relating to gifts of capital property, allowing for an elected amount not greater than the fair market value and not less than the adjusted cost base of the property, to be considered as both the proceeds of disposition of the property and the amount of the gift. Where property is transferred to an *inter vivos* trust for purposes of donating an equitable interest in the trust to a charity, the capital property that is gifted consists of the equitable interest in the trust and not the actual property transferred to the trust.[17] Given the wording of subsection 118.1(6) of the *Act*, it would appear that the provision applies to the capital property that is donated, that is, the equitable interest in the trust and not the actual property transferred to such a trust. This distinction is irrelevant where the property donated is a residual interest in real property since a limited interest in real property can be donated without resorting to a trust. However, since it is not possible to divide personal property into successive interests in the ownership of the property (such as interests for life and interests in the remainder) without resorting to a trust, it is not possible to avoid the dilemma posed by the language of the *Act* for personal property without the use of a trust.[18]

When a residual interest in real property is donated, subsection 118.1(6) of the *Act* applies to the residual interest, since it is a gift of capital property. Accordingly, a residual interest in real property can be donated to a charity on a tax-free basis. However, since a residual interest in personal property cannot be donated without using a trust, the personal property must first be transferred to a trust. An equitable interest in the trust can then be donated. Since the capital property that is transferred to the trust is not the gift, subsection 118.1(6) of the *Act* cannot apply to the transfer of such property to the trust so the transfer of property to such a trust would result in a fully taxable disposition. In order to treat the gift of an equitable interest in a trust in the same fashion as the gift of a residual interest in real property, subsection 118.1(6) of the *Act* would have to be interpreted in such a manner that it would apply to the transfer of the property to the trust. However, as noted, the property transferred to the trust is not the gift and the wording of subsection 118.1(6) of the *Act* makes clear that it applies to the capital property donated which, in the case of a charitable remainder trust, is the equitable interest in the trust. If subsection 118.1(6) of the *Act* were interpreted as applying only to the equitable interest in the trust, any transfer of property to an *inter vivos* trust for purposes of gifting a residual interest in such property to a charity would have tax consequences,[19] whereas a residual interest in real property could be

donated on a tax-free basis using the rollover provided in subsection 118.1(6) of the *Act*.[20]

However, paragraph 8 of *Interpretation Bulletin* IT-226R states that Revenue Canada will allow a taxpayer to make the election in subsection 118.1(6) in respect of the property transferred to a trust, as opposed to the capital property being gifted. These comments were apparently meant to recognize the difficulty of attempting to apply subsection 118.1(6) of the *Act* to gifts of equitable interests in trusts. Given the wording of subsection 118.1(6) of the *Act*, there seems to be no basis for this administrative position; however, it may be acceptable from a policy point of view, since it has the effect of allowing both a residual interest in real property and the property that is transferred to a trust for purposes of gifting an equitable interest in the trust, to be donated to a charity on a tax-free basis.

Nevertheless, it is not clear how to apply subsection 118.1(6) of the *Act* in accordance with the administrative practice set out in paragraph 8 of IT-226R, since the elected amount under subsection 118.1(6) of the *Act* is not only the proceeds of disposition of the property but also the amount of the gift. However, as the charity will not receive the capital of the trust until the donor's death, the gift must be valued taking into consideration the fair market value of the property, the current interest rates, the life expectancy of any life tenants and any other factors relevant to the specific case. Accordingly, although the postamble of subsection 118.1(6) of the *Act* makes it clear that the elected amount is deemed to be both the proceeds of the disposition of the property gifted and the fair market value of the gift, where the property that is gifted consists of a capital interest in a trust, the amount of the gift would be the present value of the capital interest in the trust, which is unlikely to correspond with the elected amount.[21]

2. *The Cost of the Property to the Trust*

As indicated above, under the United States *Code*, the cost of the property transferred to the charitable remainder trust by way of gift would be equal to the donor's cost base. Thus, the charitable remainder trust "steps into the donor's shoes for the purpose of computing gains and losses, and all the results are the same in dollar amount as if the donor had retained the [property] and sold [it] for his own account".[22]

Under the Canadian tax rules, however, it is not clear how to determine the acquisition cost to a charitable remainder trust of property transferred to the trust by way of gift. In our view, whether the property is gifted to a charitable remainder trust or any trust other than a spousal trust,[23] the acquisition cost of the property to the trust would be determined pursuant to paragraph 69(1)(c)

of the *Act*.[24] Therefore, the acquisition cost would be equal to the fair market value of the property at the time of the transfer to the trust. In addition, according to subparagraph 69(1)(b)(ii) of the *Act*, the donor/settlor would be deemed to have received proceeds of disposition equal to the fair market value of the property. However, given the comments in *Interpretation Bulletin* IT-226R, where a subsection 118.1(6) election is filed, the proceeds of disposition of the property may be any amount between the adjusted cost base of the property and its fair market value. As a result, the proceeds of disposition of the property to the donor and the adjusted cost base of the property to the trust could be different.[25] Since the ultimate beneficiary of the property will be a charity and a charity is a tax-exempt entity, from a tax policy perspective, this discrepancy may not be as troubling as appears at first glance. In addition, if the untaxed accrued capital gain in the property reverted to the donor in the form of income from the charitable remainder trust, it would be taxed in the hands of the donor. Nevertheless, given that the scheme of the *Act* operates so that the acquisition cost of property to a trust always parallels the proceeds of disposition of the property to the settlor, it is questionable whether it was intended that subsection 118.1(6) of the *Act* operate in such a way as to modify this precept.

3. *The Tax Status of the Charitable Remainder Trust*

Pursuant to Section 664(c) of the United States *Code*, a charitable remainder trust is exempt from taxation on its income and on gains from the disposition of appreciated property.[26] Accordingly, it can reinvest a part of its income, and more notably its capital gains, on a pretax basis.[27] As a result, a considerably larger pool of money is available to invest by the trust than the donor would have if he or she sold the assets personally and paid the applicable taxes.

The tax liability for the income and gains of the trust is, however, passed on to the trust's noncharitable beneficiaries pursuant to Section 664(b) of the *Code*. According to this provision, the income distributed by the charitable remainder trust to the income beneficiaries will be treated as distributions of: (1) ordinary income, (2) capital gains, (3) tax-exempt income and (4) return of trust principal. This four-tier system is used to characterize the income tax consequences to the income beneficiary of distribution from the charitable remainder trust. Thus, payments to the donor-beneficiary represent ordinary income to the extent of the trust's ordinary income and the rest is capital gain. Accordingly, where the trustee of a charitable remainder unitrust disposes of appreciated property, the tax liability in respect of the capital gain realized on the disposition may be deferred until such time as the trust makes a distribu-

tion to the income beneficiaries in excess of the ordinary income generated by the trust.[28]

In Canada, since charitable remainder trusts are not exempted from tax, the issue is whether the capital gains realized by such trusts are taxed in the trust's hands or whether it is possible to make these gains "payable" to the charity, within the meaning of subsection 104(24) of the *Act*, so that the capital gains would not be subject to tax.[29] As with any trust, if the trust deed makes clear that any capital gains realized by the trust will be paid or are payable to the charity, a designation under subsection 104(21) of the *Act* could be made in favor of the charity.[30] Although making the capital gains payable to the charity would essentially make the trust nontaxable, other problems may arise. Thus, if the capital gains were paid to the charity or if the charity were to enforce payment of them, the income beneficiary would probably see the income stream dwindle as the trust would not be able to use these capital gains to replace the property disposed of with new income-generating investments. On the other hand, if there was an understanding between the prospective donor and the charity according to which the charity would not enforce payment of the capital gains realized by the trust,[31] the capital gains could not be considered to be "payable" within the meaning of subsection 104(24) of the *Act*.

4. *Valuing the Gift*

Where a charitable remainder trust is settled by a United States donor, the donor is entitled to a charitable deduction under Section 170 of the *Code*, equal to the actuarial value of the remainder interest that will pass to the charity. In that respect, the rules are no different for Canadian and United States donors. There is, however, one difference and it lies in the fact that in the United States there are specific rules concerning the determination of the actuarial value.[32] As explained by Gulbrandsen and Roberts, the United States Treasury Department provides tables that determine the dollar value of the deduction, based on the term of the trust, the fair market value of the property transferred to the trust and the interest rate in effect at the time the trust agreement is executed.[33] The dollar value of the deduction varies according to the Section 7520 discount rate which is published monthly and represents a composite yield of Treasury securities.[34]

For Canadian Tax purposes, there are not such tables. According to paragraph 5 of *Interpretation Bulletin* IT-226R, the method of valuing an equitable interest in a trust will vary according to the type of gift, other interests in the trust and the documentation providing for the gift. It also suggests, as a general approach, valuing the various interests by taking into consideration the fair market value of the property itself, the current interest rates, the life

expectancy of any life tenants, and any other factors relevant to the specific case. Given these general comments on valuation and the lack of tables, it may be difficult for prospective donors to make their own determination of the actuarial value of their gifts. From Revenue Canada's perspective, the above guidelines are probably considered to be adequate since taxpayers are generally responsible for determining the value of their property for tax purposes. However, it appears that the lack of direction regarding the appropriate manner of valuing gifts of remainder interests in charitable remainder trusts has led to comparison shopping on the part of prospective donors for the charity that will give them the best discount rate.[35]

III. Other Considerations and Factors Relevant to Charitable Remainder Trusts

1. *Donor Acting as Trustee*

Under the United States rules, a donor can serve as the sole trustee of the charitable remainder trust without tainting the trust, provided that the terms of the income payments to the donor are fixed and the trustee has no power to alter them.

In Canada, where the donor acts as sole trustee or as one of two trustees who must be unanimous in respect of any decision regarding the trust, paragraph 75(2)(b) of the *Act* could apply so as to attribute the income and capital gains of the trust to the donor. The attribution rule of paragraph 72(2)(b) of the *Act* could apply, for example, where the property held by the trust can only be disposed of with the consent of, or in accordance with the direction of, the settlor of the trust.

2. *Power to Encroach on Capital*

Since, by definition, the charitable remainder annuity trust must pay a fixed annual income return, encroachment on capital is allowed to fulfil this obligation.[36] By contrast, in Canada, a charitable donation credit may be denied if the charitable remainder trust agreement authorizes encroachment on capital to pay the income beneficiary.[37]

3. *Right to Substitute the Charitable Beneficiary*

In the United States, it is acceptable to have a provision in the trust agreement that provides for the right to replace the designated charity as the charitable remainder organization. Such a provision will not adversely affect a trust's qualification as a charitable remainder trust provided that the substituted organization is a qualified organization within the meaning of Section 170(c) of the *Code*.[38] In Canada, a substitution of the charitable beneficiary should not present problems. For instance, if the charity first designated was a

charitable organization within the meaning of subsection 149.1(1) of the *Act* and the replacement charity is a Crown foundation, since claims for gifts to both charitable organizations and the Crown are limited to 75 per cent of an individual's (or corporation's) net income in a year, a change in the type of donee would be of no consequence for the amount of the donation credit or deduction claimed at the time the trust was set up.[39] In addition, although a charitable organization is required to expend in a taxation year a portion of all receipted donations,[40] where the gift received is subject to a trust, it is excluded from the calculation of the required disbursement.[41] Accordingly, if the donor replaces the charity that was expected to receive the capital of the charitable remainder trust with another charity, the charity that issued the receipt is unlikely to suffer any change in its disbursement obligations.

4. *Donation of Life Interest*

In the United States, donors who have created charitable remainder trusts and reserved an income interest in the trust for themselves are entitled to a charitable deduction if they later donate the income interest to the charitable remainder organization. The amount of the gift is considered to be the value of the remaining life interest at that time.[42] Although *Interpretation Bulletin* IT-226R does not contemplate such gifts, there would appear to be no reason why such a gift would not be considered valid for Canadian income tax purposes, although it might be difficult to value.

IV. Easy Come, Easy Go: Depletion or Depreciation of the Trust's Assets

In the United States, the trust agreement may not contain provisions imposing restrictions on the manner in which the trustees may invest trust assets if those restrictions would prevent the trustees from investing the trust's assets in a manner which would produce a reasonable amount of income or gain.[43] It would appear in fact that the American Treasury Department is concerned, not so much with the possibility that the trustees may make injudicious investments, as with the likelihood that the trust's assets may be depleted to make payments to the donor/beneficiary. For that reason, the Internal Revenue Service has imposed a requirement that the probability that the trust's assets will be exhausted before the charity receives them must be less than five per cent.[44] If this requirement is not met, a charitable deduction will not be allowed.

In Canada, as *Interpretation Bulletin* IT-226R does not require that the trustees' powers in respect of the capital transferred to the trust be restricted in any fashion, the trust agreement could give the trustees full discretion as to the management of the trust's assets. Although the trustees are unlikely to shirk

their responsibilities in this respect, they may nevertheless make an investment that proves to be improvident, leaving the charity without the expected donation and the government with lost revenue.

V. To Be or Not To Be: Wherein Lies the Future for the Charitable Remainder Trust?

Over the past few years, Canadian charities have promoted aggressively the use of charitable remainder trusts as a planned giving mechanism. However, since the charitable remainder trust has become more than a planned giving technique in the United States,[45] Canada may see similar developments in the years to come. For instance, charitable remainder trusts are used in the Untied States as part of estate freezes [46], estate planning[47] and as retirement income supplements.[48] A variation of the charitable remainder trust, namely the pooled income fund, has also achieved a certain degree of popularity in the United States with donors who do not care to deal with trust agreements and trustees.[49]

Currently, the Canadian tax treatment of charitable remainder trusts raises many issues which are not addressed by the *Act* and are not easily resolved in the absence of clear rules. For that reason and also because charitable remainder trusts are likely to become more prevalent, the Department of Finance should consider the issues relating to, and the tax policy implications of, charitable remainder trusts. If certainty and predictability in the application of the *Act* to charitable remainder trusts are to be attained, clearly defined rules in the form of legislation, rather than administrative rulings, will have to be developed.

FOOTNOTES

1. See generally, J.S. Taylor, "The Charitable Remainder Trust: A Unique Estate Planning Technique" (1991), 69 *Taxes* 106 and W.L. Hoisington, "The Truth About Charitable Remainder Trusts" (1992), 45 *The Tax Lawyer* 293.
2. The topic of charitable remainder trusts has been discussed at many recent conferences: see B. Bromley, "Creative Planning of Charitable Donations" in *Report of Proceedings of the Forty-Eighth Tax Conference, 1996 Conference Report* (Toronto: Canadian Tax Foundation, 1997) at 56:1; B. Bromley, "Charitable Remainder Trusts: A Valuable Tax Planning Alternative" (Conference of the Strategy Institute, *Charitable & Planned Giving Strategies: High Net-Worth Advisors Forum,* Toronto, July 9, 1997); and W.D. Goodman, Q.C. & L.R. Simone, "Charitable Remainder Trusts" (Conference of the Canadian Bar Association – Ontario, *Charity and Not-for-Profit Law, The Emerging Specialty,* Toronto, May 15, 1997). [See also B. Bromley, "Planned Giving Instruments: The Trust Spectrum" (1991), 10 *Philanthrop.* No. 2, pp. 3-19.]
3. R.S.C. 1985, c.1 (5th Supp.), hereafter referred to as "the *Act*".

4. *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.
5. *Ibid.*, at paragraph 1.
6. *Ibid.*, at paragraph 3.
7. *Ibid.*, at paragraph 2.
8. In his submission to the Forty-Eighth Tax Conference (*supra*, footnote 2 at 56:20), Blake Bromley perceptively notes that, as regards gifts of equitable interests in charitable remainder trusts, it would be impossible to meet this requirement of the definition of "gift" if the "residual interest was not notionally severed from the income interest, because a charitable remainder trust invariably gives the donor the right to, and material benefit of, receiving income from the life interest.
9. In such circumstances, the trust agreement may also provide for the beneficiary to receive amounts from current trust income, if such income exceeds the required unitrust amount, to the extent the beneficiary received payment of less than the required unitrust amount in previous years. (Section 664(d)(3)(B) of the *Code.*)
10. See M.A. Chirelstein, *Federal Income Taxation*, 7th ed. (Westbury, New York: The Foundation Press, Inc., 1994) at 163.
11. Section 1015 of the *Code.*
12. Although the donation of appreciated property entitles the donor to a charitable deduction, the percentage of income against which the deduction can be taken is reduced from 50 per cent to 30 per cent where the donated property has a built-in capital gain. (Section 170(b)(1)(C) of the *Code.*)
13. The combined benefit of the deduction and the non-realization of capital gains or income has been criticized as being excessive. The critics argue that the gift of property should be considered equivalent to a realization. Charities, however, oppose the realization idea since they fear that it would cause donors to reduce the size of their donations by contributing only their net after-tax proceeds. (*Supra*, footnote 10 at 163-164.)
14. The popularity of the charitable remainder trust "may have less to do with increasing charitable desires and more to do with the perceived tax savings associated with the charitable remainder trust". (J.S. Gulbrandsen & D.B. Roberts, "CRATS, CRUTS and NIMCRUTS: Philanthropy Or Prosperity?" (1996), 135:7 *Trusts & Estates* 53 at 53.)
15. See *Income Tax Technical News* No. 7, "Revocable Living Trusts", February 21, 1996.
16. It is also not clear whether paragraph 38(a.1) of the *Act* which provides for a reduction (from 75 per cent to 37.5 per cent) in the income-inclusion rate for capital gains arising where shares trading on a prescribed stock exchange are donated to a charity would apply to the transfer of such shares to a charitable remainder trust for the benefit of a charity.
17. This has been recognized by Revenue Canada for quite some time, as evidenced by its response to question 38 of the Revenue Canada Round Table at the 1981 Canadian Tax Foundation annual conference; "although a charity may be desig-

nated a capital beneficiary of the trust, the capital interest that it acquires is not the property which was disposed of by the taxpayer". See "Report of Proceedings of the Thirty-Third Tax Conference", *1981 Conference Report* (Toronto: Canadian Tax Foundation, 1982) at 754.

18. E.G.L. Tyler & N.E. Palmer, *Crossley Vaines' Personal Property*, 5th ed. (London: Butterworths, 1973) at 41-42.

19. Blake Bromley, *supra* footnote 2 at 56:24, questions why Revenue Canada does not articulate a clear policy guideline stating that a transfer to a charitable remainder trust will be treated in the same fashion as a transfer to a protective trust, which does not result in a disposition, pursuant to paragraph (e) of the definition of "disposition" in section 54 of the *Act*. In the absence of such a guideline, he recommends that donors set up a protective trust or a personal representative trust and subsequently donate a remainder interest in the trust to the charity thereby avoiding the disposition that would otherwise occur when property is transferred to a charitable remainder trust. Although Revenue Canada has not commented on this course of action, we surmise that the Department may consider applying the general anti-avoidance rule where there is no intention, at the time the trust is settled, that it retain its character as a protective trust or personal representative trust.

20. Although section 43.1 of the *Act* deems a taxpayer who has disposed of a remainder interest in real property while retaining the life estate, to have disposed of the life estate for fair market value, this provision does not apply where the remainder interest is donated to a charity.

21. This problem would not arise where a residual interest in real property is gifted since the donor would be considered to have disposed of the interest for an amount equal to its present value.

22. *Supra*, footnote 10 at 59.

23. Where property is transferred to a spousal trust, the cost of the property to the trust is equal to the proceeds of disposition of the property to the settlor which, in the case of non-depreciable capital property, would be the property's adjusted cost base. (See paragraphs 70(6)(d) and 73(1)(f) of the *Act*.)

24. As noted by B. Bromley, although charitable remainder trusts are considered to be charitable instruments, for purposes of the *Act* they are simply taxable trusts. (*Supra*, footnote 2 at 56:19.)

25. Where a residual interest in real property is gifted to a charity and a subsection 118.1(6) election is filed by the donor, a similar result may occur, i.e., the proceeds of disposition of the property may not parallel its acquisition cost to the charity.

26. A charitable remainder trust may, however, lose its tax-exempt status if, in any particular taxation year, it has unrelated-business taxable income within the meaning of section 512 of the *Code*.

27. As noted by Hoisington, *supra*, footnote 1 at 306, "this is the characteristic of a CRT that makes it possible for the discounted present value of the future payments from the CRT to exceed the discounted present value of the investment returns [the donor] would have received if [he or she] had retained the property".

28. For instance, if a trust funded with appreciated property called for an income distribution of 10 per cent and it only earned eight per cent, the 10 per cent would be characterized as eight per cent ordinary income and the two per cent as capital gains. (For a further example, see *supra*, footnote 14 at 54.)
29. Since the income of the charitable remainder trust would, in most cases, be payable to the donor or another beneficiary, it is unlikely to remain within the trust. However, as capital gains are not considered to be income for trust law purposes, they would remain within the trust.
30. See Revenue Canada, Business and General Division, *Tax Window Files* (Don Mills, Ont.: CCH Canadian Limited) [database online], document no. 9429135, January 26, 1995.
31. According to B. Bromley, (*supra*, footnote 2 at 56:25-26), if a charitable organization failed to enforce payment of the capital gains realized by the trust, it could be in breach of its obligation to devote all of its resources to charitable activities, as required by the definition of "charitable organization" under subsection 149.1 of the *Act*. In his view, this problem can be avoided by resorting to section 105 of the *Act* and by ensuring that the trust agreement clearly states that the capital gains realized by the trust enure to the benefit of the charity as a capital beneficiary.
32. Treasury Regulations Section 1.664-4.
33. *Supra*, footnote 14 at 54.
34. J.A. Soled, "The Versatile Use of Charitable Remainder Unitrusts" (1996), 74 *Taxes* 308 at 309. Treasury Regulation Section 1.7520-2(a)(2) and IRS publications 1457 and 1458 set out the information needed for calculating the value of the remainder interest.
35. Such incidents were related to the author by a representative of the Canadian Association of Gift Planners and are therefore purely anecdotal.
36. Section 664(d)(1)(A) of the *Code*.
37. *Supra*, footnote 4 at paragraph 6.
38. C. Teitell, "Unitrusts: Some Noteworthy Developments" (1996), 135:2 *Trusts & Estates* 63 at 63.
39. Subsection 118.1(1) of the *Act*.
40. Subsection 149.1(2) of the *Act*.
41. Subsection 149.1(2) of the *Act*.
42. *Supra*, footnote 38 at 63.
43. Treasury Regulation 1.664-1(a)(3).
44. This is known as the Five Per Cent Probability Test. The formula is provided in Rev. Ruling 77-374. The test does not apply to a charitable remainder unitrust, since the payments to the income beneficiaries are based on a percentage of the annual fair market value of the assets of the trust and there is therefore no probability that the charity will receive nothing. (*Supra*, footnote 14 at 54.)

45. See generally, C. Teitell, "Funding Charitable Remainder Trusts With Innovative Assets" (1993), 132:1 *Trusts & Estates* 53 and N.P. Myerberg, "Retirement Fund Assets Can Be Protected Through the Use of Charitable Remainder Trusts" (1995), 82:1 *J. of Taxation* 38.

46. Taylor, *supra*, footnote 1 at 113 and W.C. Smith, "Gifts of Family Corporate Stock" (1996), 135:1 *Trusts & Estates* 16.

47. Goodman & Simone, *supra*, footnote 2 at 7.

48. A charitable remainder unitrust can be used as a retirement vehicle by investing the property contributed to the trust in low-yield, highly appreciating assets. Since a charitable remainder unitrust can distribute to the income beneficiary the lesser of the actual trust income and the unitrust amount provided in the trust agreement, the trust is able to accumulate large distribution buildups. In addition, since a charitable remainder unitrust can provide for the beneficiary to receive amounts from current trust income that exceed the required unitrust amount, to the extent the beneficiary received payment of less than the required unitrust amount in previous years, upon the donor's retirement, the trustee could reinvest the trust's assets in high-yield, low-growth investments and trigger the charitable reminder unitrust distribution buildup. (*Supra*, footnote 34 at 310-311 and Taylor, *supra*, footnote 1 at 111.)

49. In a pooled income fund, a donor's contributions are pooled with those of others. Like a charitable remainder trust, the fund pays the donor his or her share of the income of the fund and upon the donor's death, the appropriate share of fund property is distributed to the sponsoring charity. (See J.J. McCoy, "Tax Planning: Beyond the Charitable Remainder Unitrust" (1993), 132:8 *Trusts & Estates* 24 at 26.