Representations to Finance Canada Regarding Changes in the Income Tax Act Relating to Charitable Gifts*

1 Subsection 110 (2.1) of the *Income Tax Act* treats a gift made by will as though it had been made by the donor in the taxation year in which he died. Such a gift is therefore deductible from the donor's income for his terminal year but the deduction is still limited to "20% of the income of the taxpayer for the year". This limitation creates two serious problems:

(a)If the donor dies early in the year, his income for the terminal year is likely to be quite small and the deduction for the charitable gift will be reduced accordingly.

(b)A considerable number of people make charitable gifts in their wills of amounts which substantially exceed those which they gave annually during their lifetimes.

Under Section 110(1)(a) of the *Income Tax Act,* donors of charitable gifts are ordinarily entitled to a one-year carry-forward of charitable contributions which exceed the amount which is currently deductible. However, this carry-forward is of no assistance to a deceased taxpayer, who obviously does not have a taxation year after his terminal year. Relief is therefore required in two areas:

(a)There should be an unlimited right to deduct charitable contributions from income in the year of death. We do not really know what reason there is for limiting the deduction for charitable contributions made during a donor's lifetime to 20% of his income but, whatever the reason, it surely cannot apply to testamentary charitable bequests

(b)The deceased donor should be entitled to a one-year carry back of any contributions in excess of those deductible in the year of death. This would parallel the treatment in Section 71 of allowable capital losses realized, or deemed to be realized, in the year of death.

2 In recent years, federal income tax legislation has tended to provide tax incentives to taxpayers to make certain types of socially desirable investments, by giving them the right to deduct in a single year or over a few years amounts which would otherwise be deductible only over many years. An unintended consequence of this legislation has sometimes been to reduce the incomes of these taxpayers to levels which result in their no longer being able to deduct the whole of their normal annual charitable contributions because of the 20% limitation in paragraph 110(1)(a).

**Representations made to the Department of Finance on November 18, 1980 by Wolfe D. Goodman, Q.C., D. Jur; Bonnie Thorn; Gordon L. Jacobs, Barrister and Solicitor; Orval J. McKeough, Director of Development, York University; K.P. Burke, Controller's Office, University of Toronto and Benjamin Schneider, consultant and former Executive Director of the United Jewish Welfare Fund of Toronto.*

While such taxpayers have the right to carry forward their excess contributions for twelve months, this carryover is insufficient to deal with what is sometimes a continuing problem. At the very least, a one-year carry back of excess charitable contributions is required. In addition, if the taxpayer is an individual, the tax deductions which he was allowed in earlier years are frequently recaptured in the year of his death or, if he leaves property by will to his spouse or to a spousal trust, it should also be possible to carry over any remaining excess for their benefit.

3 Revenue Canada has already published a ruling which indicates that it is possible for an individual to sell appreciated capital property to a charitable organization, with payment to be made over a period of years, on the understanding that each payment will be forgiven by an annual charitable contribution. This technique enables the individual to spread his liability for tax on his taxable capital gain over a period of years and, at the same time, to obtain the maximum possible deduction for his charitable contributions.

A simple example will illustrate this situation. An individual with income of $50,000 per year wishes to transfer to a charitable organization securities which cost him $25,000 and which are now worth $125,000. If he were to give them to the charity in a single year, he would be deemed by paragraph 69(1)(b) to have realized a taxable capital gain of $50,000. This would increase his income for the year of his gift from $50,000 to $100,000, but he would be able to deduct only $20,000 of his $125,000 gift in that year. In the next year, if he made no other charitable contributions, he could deduct a further $10,000. However, no more than a total of $30,000 could be deducted in respect of his gift of $125,000.

However, if he were to enter into an agreement to sell these securities to the charity for $125,000, to be paid at the rate of $25,000 per year over five years, on the understanding that he would forgive $25,000 of the purchase price each year, the situation would be very different. Although he would still realize a capital gain of $50,000 in the year of sale, subparagraph 40(1)(a)(iii) would entitle him to spread this gain over five years, at the rate of $10,000 per year. His income would therefore be increased to $60,000 per year and he would be entitled to deduct $12,000 per year as a charitable contribution. As a result, a total of $60,000 could be deducted in respect of his gift of $125,000, as compared with only $30,000 in the previous example.

There seems no reason why this principle should not be extended to include public and private charitable foundations as well as charitable organizations. It is not entirely clear whether the statutory restrictions in subsections 149.1(3) and (4) in respect of a foundation which incurs certain types of debts will apply to debts for the "purchase" of investments, when these debts are not going to be paid in any event. It may not actually be necessary to amend the *Income Tax Act* in order to deal with this situation and it may be sufficient to deal with it by means of a published Income Tax Ruling or Interpretation Bulletin.

4 Serious problems are being encountered when potential donors wish to make gifts of capital property to a charitable organization or a public or private charitable foundation. Paragraph 69(1)(b) provides that the donated property is deemed to have been disposed of at its fair market value, but the taxpayer's deduction for his charitable contribution may be restricted by their 20%

limitation in paragraph 110(1)(a). For example, if an individual, with an ordinary income of $100,000, makes a gift to charity of shares which cost $100,000 but which are now worth $1,000,000, he will realize a taxable capital gain of $450,000, bringing his total income to $550,000, but his charitable donation deduction will be only 11% of the amount of his donations.

Section 110(2.2) provides a special rule whereby certain gifts to charity can be subject to an election by the taxpayer of any amount between the adjusted cost base of the donated property and its fair market value; the elected amount is then treated as the proceeds of disposition of the donated property and as the amount deductible under paragraph 110(1)(a). However, this subsection is presently restricted to "tangible property that could reasonably be regarded as being suitable for use by the donee directly in the course of carrying on its charitable, service or other similar activities."

Problems presently arise where individuals who own substantial blocks of shares, sometimes amounting to a controlling interest, wish to donate part of their holdings to a charitable organization or foundation. These shares are normally marketable only after a prospectus has been filed with the appropriate Securities Commissions, which requires the expenditure of a good deal of time and money. In any event, it is usually the donor's intention that the donated shares not be sold but, rather, be held indefinitely for the benefit of charity. We can understand the Government's reluctance to permit appreciated securities to be given by an individual to a charity without payment of tax by the donor on the appreciation in their value in the donor's hands, if the charity then sells these securities within a few years. However, different considerations arise if the securities will be held more or less indefinitely by the charity. We therefore suggest that the principle of subsection 110(2.2) be extended to include any gift of property of any kind to any charitable organization or public or private foundation, with appropriate safeguards to Revenue Canada in respect of property which is resold by the charity within a few years.

5 If an individual settles property during his lifetime on a trust, the income of which would be payable to his spouse or his children during her or their lifetime(s), with the capital eventually going to charity, Revenue Canada is prepared to allow the individual an immediate deduction under paragraph 110(1)(a) in respect of the discounted present value of the capital interest which has been settled on the charity; see Interpretation Bulletin IT-226, paragraph 1. However, we understand that Revenue Canada has ruled that this principle does not apply to testamentary bequests nor to interests in personal property, whether these are given during the donor's lifetime or by will. We are quite unable to understand the reason for this distinction and we suggest that the same reasonable rule should apply to testamentary bequests as well as to inter vivos gifts and to personal property of any kind as well as to real property.