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PRINCIPAL ISSUES: Whether certain donation amounts claimed by various taxpayers were all gifts by will

POSITION: Yes
REASONS: See memo

January 2, 2014
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Estate of the Late XXXXXXXXXX

We are writing in response to your May 23rd, 2013 request for our comments concerning a current audit of the XXXXXXXXXX T3 return of the Estate of the late XXXXXXXXXX (the “Estate”) which revealed that three charitable donations totaling $XXXXXXXXXX were made after the date of death of the late XXXXXXXXXX (the “Deceased”). They were as follows:

* $XXXXXXXXXX claimed by the Estate in its FYE XXXXXXXXXX

* $XXXXXXXXXX claimed by XXXXXXXXXX (“Holding”) in XXXXXXXXXX as follows:

o $XXXXXXXXXX for the short fiscal year-end (“FYE”) XXXXXXXXXX, and

o $XXXXXXXXXX for the short FYE XXXXXXXXXX

* $XXXXXXXXXX claimed in the final XXXXXXXXXX T1 return of the Deceased.

You wanted to know whether each of the above noted donations claimed by each taxpayer were appropriate for purposes of the Income Tax Act (the “Act”).

Summary Comment(s)/Conclusion(s):

1. It is our opinion that the $XXXXXXXXXX in marketable securities transferred by the Estate to the Foundation (as defined in 6 below) on XXXXXXXXXX and XXXXXXXXXX constitute a gift by will

under subsection 118.1(5) of the Act and is deemed to have been made by the Deceased immediately before his death.

2. With respect to the $XXXXXXXXXX amount claimed by Holding, we comment as follows:

* To the extent the $XXXXXXXXXX donation is determined to be a gift made pursuant to the Will of the Deceased, it is our opinion that the $XXXXXXXXXX in marketable securities transferred by Holding on behalf of the Estate to the Foundation on XXXXXXXXXX and XXXXXXXXXX constitutes a gift by will under subsection 118.1(5) of the Act and is deemed to have been made by the Deceased immediately before his death.

3. Alternatively, if it were determined that the $XXXXXXXXXX was a charitable gift made by Holding pursuant to subsection 110.1(1) of the Act, then subject to the limitations in paragraph 110.1(1)(a) and subsection 110.1(1.1) of the Act and subject to the provision in subsection 110.1(6) of the Act, it is our view that Holdings may deduct the appropriate amount. It is our opinion that the $XXXXXXXXXX amount claimed formed part of the gift by will of the Deceased and is deemed to have been made by the Deceased immediately before his death. Therefore, the deduction taken is appropriate even if the submission provided was an attempt to avoid a reference to gift by will.

Our understanding of the facts:

4. The Deceased passed away on XXXXXXXXXX. Prior to his death he was the majority shareholder of Holding, an investment holding company. The primary assets of Holding were marketable securities. Immediately before the death of the Deceased, the share ownership of Holding was distributed as follows:

* The Deceased XXXXXXXXXX Class A common shares

* A son of the Deceased XXXXXXXXXX Class B common shares

* A daughter of the Deceased XXXXXXXXXX Class B common shares

Both the son and daughter of the Deceased noted above are non-residents.

5. It is our understanding that the XXXXXXXXXX Class A common shares of Holding (the “Estate Shares”) held by the Deceased immediately before his death represent about XXXXXXXXXX% of the residue of the Estate. The original trustees of the Estate named in the Will were XXXXXXXXXX and XXXXXXXXXX (the “Original Trustees”) and neither is related to the Deceased or any member of his family. It is also our understanding that the estimated fair market value of the Residue as at the date of death was about XXXXXXXXXX the total charitable donations of $XXXXXXXXXX that is at issue in the current analysis.

6. The Deceased’s original will (the “Will”) dated XXXXXXXXXX, instructed the trustees to divide the residue of his estate into two equal shares and to pay or transfer such shares as follows: (emphasis added)

* XXXXXXXXXX.

* XXXXXXXXXX.

7. According to clauses XXXXXXXXXX and XXXXXXXXXX of the Will, the discretionary powers of the trustees are as follows: (emphasis added)

XXXXXXXXXX.

8. Although a $XXXXXXXXXX donation payable was reported on the XXXXXXXXXX financial statements of Holding, it was not settled until the subsequent FYEs as follows:

* For the short FYE XXXXXXXXXX, a donation deduction of $XXXXXXXXXX was claimed by Holding. The Foundation provided a document detailing the marketable securities received on XXXXXXXXXX from Holding to settle this amount. The Foundation also indicated they issued a donation receipt for $XXXXXXXXXX on XXXXXXXXXX. The auditor confirmed that a charitable receipt was issued and received on the basis of the Foundation's receipt of the Deed of Gift for the amount.

* For the short FYE XXXXXXXXXX, the remaining donation deduction of $XXXXXXXXXX was claimed by Holding. The Foundation provided a document detailing the marketable securities received on XXXXXXXXXX from Holding to settle this amount. The Foundation also indicated that it issued a donation receipt for $XXXXXXXXXX on XXXXXXXXXX. The auditor also confirmed that a charitable receipt was issued and received on the basis of the Foundation's receipt of the Deed of Gift for the amount.

9. On XXXXXXXXXX, Holding redeemed all of the Class B common shares held by the above noted son and daughter of the Deceased making the Estate the sole shareholder of Holding.

10. On XXXXXXXXXX, the Estate concluded that it would be best to windup Holding and as a first step, subscribed to XXXXXXXXXX newly created Class Z common shares for a nominal amount. On XXXXXXXXXX, the following sequential steps were undertaken:

a. Substantially all of the remaining marketable securities held by Holding were sold to the Estate for $XXXXXXXXXX pursuant to a securities purchase agreement. The Estate settled the purchase by assuming $XXXXXXXXXX in liabilities of Holding and by issuing a demand promissory note with a face value of $XXXXXXXXXX.

b. Holding then declared a dividend on its Class A common shares as a capital dividend to the Estate of $XXXXXXXXXX. Holding settled the dividend by issuing XXXXXXXXXX demand promissory notes with a face value of $XXXXXXXXXX.

c. Holding then declared an eligible dividend to the Estate for $XXXXXXXXXX and settled it with a demand promissory note with a face value of $XXXXXXXXXX.

d. Holding then redeemed the Estate Shares held by the Estate for $XXXXXXXXXX.

e. The remaining shell of Holding was ultimately held by the XXXXXXXXXX children of the Deceased through their purchase of the XXXXXXXXXX Class Z common shares for nominal amounts.

11. In a consent order dated XXXXXXXXXX obtained by the Original Trustees from the XXXXXXXXXX Court, the Court ordered that

* XXXXXXXXXX resign as trustee, to be replaced by XXXXXXXXXX making the latter and XXXXXXXXXX the trustees (the "New Trustees"). XXXXXXXXXX is not related to the Deceased or any member of his family.

* That the absolute discretion of the New Trustees as provided for in the Will shall include the discretion to transfer the Foundation's share of the Estate to the Foundation either directly or indirectly, so as to allow for the most tax effective distribution of the Estate, provided no prejudice to any beneficiary results.

12. In the original T1 final return of the Deceased, a capital gain of $XXXXXXXXXX was reported on the deemed disposition of the Estate Shares. A T1 adjustment request was subsequently filed with respect to an election under subsection 164(6) of the Act to carry back $XXXXXXXXXX in capital losses from the Estate to the T1 final return of the Deceased. The capital loss incurred in the Estate was the result of the redemption of the Estate Shares by Holding for $XXXXXXXXXX. It is our understanding that the capital loss amount is correct and that the audit has concluded that the stop loss rules in subsection 112(3.2) of the Act did not apply to reduce the said capital loss.

13. A charitable donation of $XXXXXXXXXX was claimed in the T1 final return of the Deceased. It is our understanding that a cheque for the amount was issued by the Estate to the Foundation on XXXXXXXXXX and a charitable receipt was received by the Estate in return on the same date. XXXXXXXXXX.

14. A charitable donation of $XXXXXXXXXX was claimed by the Estate in its FYE XXXXXXXXXX. To support the charitable donation, the representative for the Estate provided a charitable receipt from the Foundation. The receipt stated that the Foundation received $XXXXXXXXXX from the Estate on XXXXXXXXXX in the form of demand promissory notes payable by Holding, such securities being "non-qualifying securities" for the purposes of section 118.1 of the Act. However, the requirement of paragraph 118.1(13)(c) of the Act was met when the promissory notes were settled by the transfer of $XXXXXXXXXX in marketable securities from the Estate to the Foundation between XXXXXXXXXX and XXXXXXXXXX.

Issue Analysis:

The $XXXXXXXXXX in Donations claimed in XXXXXXXXXX by the Estate

Relevant Legislation:

15. Subsection 118.1(5) of the Act states that (emphasis added)

Subject to subsection (13), where an individual by the individual's will makes a gift, the gift is, for the purpose of this section, deemed to have been made by the individual immediately before the individual died.

Analysis:

16. In severed document E2011-0428021 dated December 14th, 2011, we opined that (emphasis added)

The tax implications of a testamentary gift to a registered charity (or other qualified donee) generally depend upon the terms and conditions of the deceased's will. Where the amount given to registered charity (or other qualified donee) constitutes a gift "by the individual's will" within the meaning of subsection 118.1(5), when the gift is completed it is deemed to have been made, for tax purposes, immediately before the individual died, and a donation tax credit may be claimed in the final T1 return. To the extent that an amount in respect of the gift cannot be claimed that year, the gift is deemed to have been made in the year preceding death. No amount in respect of a gift by the individual's will may be claimed in a T3 return.

17. In severed document 2011-040840 dated June 23rd, 2011, we opined that (emphasis added)

Pursuant to subsection 118.1(5) of the Act, a gift made by an individual's will is deemed to have been made, for purposes of subsection 118.1(1), immediately before the individual's death, and as such, is claimed in the final T1 return of the deceased taxpayer. For the purposes of this subsection, a gift is

considered to have been made "by the individual's will" where the executors of the estate are required to transfer a specific property or amount to a recipient that is a qualified donee. The term "gift" is not defined in the Act and therefore assumes its common law meaning. Under common law, a bona fide gift is a voluntary transfer of property from a donor, who must freely dispose of his or her property, to a donee, who receives the property given with no right, privilege, material benefit or advantage conferred on the donor or any person designated by the donor in exchange for the donor making the gift. Proposed subsections 248(30) to (32) of the Act allow for the recognition of a gift for tax purposes in certain situations where a donor, or a person or partnership who does not deal at arm's length with the donor, receives consideration or other advantages for property transferred. Pursuant to proposed subsection 248(31), the eligible amount of a gift is the excess of the fair market value ("FMV") of the property transferred to a qualified donee over the amount of the advantage provided.

18. In severed document 2001-009020 dated April 11th, 2002, we opined that (emphasis added)

We expect that in the majority of cases the testator would have identified a specific charity or charities as the intended recipients of the donation in which case concerns as to whether the donation would constitute a gift by will should not arise. However, in a situation where an individual's will directs his or her trustee to make a donation to charity without identifying a particular charity, it is now our view that this, in itself, would not necessarily preclude the donation from otherwise qualifying as a gift by will. In this regard, an individual would generally be considered to have made a gift by will for the purpose of subsection 118.1(5) of the Income Tax Act if the terms of his or her will provide for a donation of a specific property, a specific amount or a percentage of the residual of the individual's estate to charity, it is clear from the terms of the will that the trustee is required to make the donation, the estate is able to complete the donation after the payment of its debts, and the donation is made to a qualified donee.

19. It is our understanding that the Estate's representative made a submission in two parts as follows

* If the trustees have sufficient discretion to decide whether or not to make a donation and how to make that donation, then it may not qualify as a charitable bequest at the time of death and it would not fall under subsection 118.1(5) of the Act and therefore, the Estate could claim the donation tax credit under subsection 118.1(3) of the Act. The representative then referred to the consent order dated XXXXXXXXXX from the XXXXXXXXXX Court detailed in 11 above.

* The $XXXXXXXXXX in donation was in the form of a demand promissory note and under the current circumstances, a non-qualifying security as defined in subsection 118.1(18) of the Act. It would be deemed to be donated at the time it ceased to be a non-qualifying security, which would be at the time the note was settled and which was at a later time than the time of death.

20. We comment as follows

* The discretion of the Trustees, including the additional discretion obtained under the consent order, does not alter the fact that under the Act, the specific bequest to the Foundation is a gift by will and subject to the provisions of subsection 118.1(5) of the Act. That is, any payment or transfer by the Estate to the Foundation, up to $XXXXXXXXXX, constitutes a gift by will for tax purposes.

* The incidence of subsection 118.1(18) of the Act does not alter the fact that when the gift is ultimately settled, it remains a gift by will for purposes of the Act.

21. As noted in 7 above, the Will of the Deceased clearly provided that half the residue in the Estate was to be paid or transferred to the Foundation, a registered charity for purposes of the Act. Nothing in the terms of the Will provided for any discretionary powers vested in the Trustees to modify this specific bequest. Therefore, it is our view that subject to the provisions in subsection 118.1(13) of the Act, up to $XXXXXXXXXX or half the value of the Estate residue that is paid or transferred by the Estate to the

Foundation constitute charitable gifts under subsection 118.1(5) of the Act and deemed to have been made by the Deceased immediately before his death.

22. Where an individual makes a gift of property that is a non-qualifying security of the individual (and the gift is not an excepted gift), the gift is deemed not to have been made at that time, pursuant to subsection 118.1(13). Generally, pursuant to paragraph 118.1(13)(c), where the non-qualifying security is disposed of by the donee within 60 months, the donor may be treated as having made the gift (the value of which is deemed pursuant to that paragraph) at this later time. However, it should be noted that by virtue of subsection 118.1(15), in this case, for purposes of section 118.1, the gift shall be deemed to have been made by the Deceased immediately before his death.

23. Based on the foregoing, it is our opinion that the $XXXXXXXXXX in marketable securities transferred by the Estate to the Foundation on XXXXXXXXXX and XXXXXXXXXX constitute gift by will under subsection 118.1(5) of the Act and is deemed to have been made by the Deceased immediately before his death.

The $XXXXXXXXXX in Donations claimed in XXXXXXXXXX by Holding

24. Section 110.1 of the Act provides that a corporation will be allowed to claim its charitable donations as a deduction, subject to certain limitations. The charitable donation that may be claimed is determined pursuant to paragraph 110.1(1)(a) of the Act. Paragraph 110.1(1.1)(a) of the Act dictates that once the amount of a gift has been deducted in a taxation year, it may not be carried forward for future deductions. Paragraph (b) provides that gifts will be considered to be deducted in on a “first-in, first out” basis. Finally, subsection 110.1(6) of the Act makes applicable to corporations the rules dealing with donations by an individual of certain types of non-arm's length gifts in subsection 118.1(13) and (14) as well as subsections 118.1(16) to (20) of the Act.

25. The representative of Holding provided the following submissions: (emphasis added)

* The $XXXXXXXXXX in donation was solely allocated to the Estate’s shares of Holding because the donation was made pursuant to Will. The accountant did not feel that the donation should impact the other shareholders so the entire donation was allocated to Estate’s shares.

26. Although the donation was made pursuant to the Will, the consent order gave the trustees the absolute discretion to make the donations in any way to allow for the most tax effective distribution of the Estate. Given the facts as noted above, it is our opinion that the better view is that the $XXXXXXXXXX in marketable securities transferred by Holding on behalf of the Estate to the Foundation on XXXXXXXXXX and XXXXXXXXXX constitutes a gift by will under subsection 118.1(5) of the Act and is deemed to have been made by the Deceased immediately before his death.

The $XXXXXXXXXX in Donations claimed in the XXXXXXXXXX T1 final of the Deceased

27. It is our opinion that this amount formed part of the gift by will of the Deceased and is deemed to have been made by the Deceased immediately before his death. Therefore, the deduction taken is appropriate.

Phil Kohnen
for Director
Trusts Section I
Financial Industries and Trusts Division
Income Tax Rulings Directorate
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