

Donating Real Property

HERE for
GOOD

Many Canadians have seen tremendous growth in the value of real estate investments, especially over the last 10 years. At some point you have to consider what, when and how to deal with the disbursement of wealth tied up in real property. For charitably minded people, a gift of real estate is simply another option to consider, along with donating stocks, bonds or cash to fulfil philanthropic intentions. This brochure about gifts of property was written to arouse curiosity and to present some of the available ways that a donation of real estate can be made.

For the most part, this guide will be discussing the different ways of dealing with capital property rather than property held as inventory. Gifts of property can certainly be made from inventory but there are usually no capital gains involved. Carleton University has specific policies and procedures for gifts of real estate. The University will consider outright and testamentary gifts of real property but retain the right to accept or decline any gift.

Are there tax implications to donating property?

Donating investment properties and vacation properties is a taxable event

but in almost all cases the charitable gift receipt will more than offset any taxable gains in property value.

In Canada, investment in your principal residence can grow and is exempt from taxation on gains in capital value. Donating a principal residence can have a very positive effect on your tax bill. The tax credit generated by donating non-taxable property can be used to offset tax liabilities on other assets and income. For example the tax credit may be used to facilitate a tax-free withdrawal from your RRSP/RRIF or other investments.

A principal residence can be passed on to heirs without capital gains taxation, except that, when dealt with through an estate, the executor must apply for the exemption and the full value will be subject to probate and other estate management fees.

What are the rules?

The rules for making charitable donations of real property are entrenched in the Income Tax Act and are reasonably similar for individuals and private corporations. Canada Revenue Agency has developed interpretive guidelines for charitable gifts of property, and we will cite references to the Act and various bulletins for those who want further information.

The key elements of an eligible charitable gift are:

1. There must be a voluntary transfer of property with a clearly ascertainable value, and ;
2. any advantage to the donor in regard to the gift must be clearly identified and its value ascertainable as well.¹

Here is a simple illustration:

A building is donated, and the charity assumes a mortgage which was existing on the property. If the value of the

building is \$1,000,000 and the value of the mortgage is \$400,000 then the donation receipt would be \$600,000. Both values were clearly ascertainable by independent appraisals.

How to make a gift of real property to Carleton University

The donor is required to fill out and sign the form “Declaration of Intent to Donate Real Property” available from the Planned Giving office in University Advancement. After preliminary approval, Carleton University will arrange all necessary appraisals and environmental assessments. If the gift receives final approval, a donation receipt will be issued. In most cases, donated properties would be sold and the net proceeds of the sale allocated to the purpose for the gift as prearranged with the donor.

What are the options?

Outright gift: this refers to a charitable gift of real property made during your lifetime that is wholly owned or mortgaged. It could be a principal residence or investment/rental property. Complete ownership is transferred and mortgage assumed by the University.

Testamentary gift: this refers to a gift of real property made in your Will. If the property is a specified gift it is valued at the date the gift is received by charity and a donation receipt for that value is issued to the estate. If the property is disbursed in-kind by the executor in fulfilment of an unspecified or residual gift to Carleton University then the donation receipt would be issued for its appraised value at the date of transfer.

Residual Interest gift: this refers to a gift of property where the donor retains right(s) to the property for certain purposes. If a person donates a principal residence, the donor could retain the right to live there for life. Or, if the gift is income property, the donor may retain the right to receive the rents for a number of years or for his or her lifetime. These gifts require the charity to retain ownership of the property until the donor's interest obligations have been met. A life estate agreement is registered in the land title office. Donation receipts are issued according to market value appraisals and actuarial valuation of the donor's retained rights.²

Charitable Remainder Trust: this refers to a legal Trust that is created either during life or in a person's Will that results in an irrevocable future gift to charity but allows the income from the Trust to be paid to a beneficiary

according to the terms of the Trust arrangement. Capital property can be transferred to a Charitable Remainder Trust but anyone contemplating this kind of gift plan needs to know that tax treatment of capital gains is not clear. Consultation with a team of experienced advisors is necessary; lawyer, trust officer, accountant and charitable gift planner should all be involved. The donation receipt is based on an actuarial valuation of the present value of the Trust.^{2,3,4,5}

A story about charitable tax planning for Roger and May

Roger and May owned an apartment building near campus for nearly 50 years. They both worked hard and were very careful with money. A couple of years ago, May passed away and Roger, now 77, decided that he no longer wanted the responsibilities and headaches of looking after the building. Many of his tenants over the years have been young faculty and grad students, and he has become partial to the University. Even though he was not an alumnus, it would not be unusual to see him on campus at sports and music events, special lectures or working out in the gym.

Roger called the Planned Giving office to say that he had created a legacy gift in his Will as a memorial for May. He also

mentioned that he had been thinking about donating an apartment building but wanted to continue living in his unit, rent free for the rest of his life. He had discussed the idea with his accountant who suggested that he give us a call. Is there a way to do this? Although it is a complex arrangement, it can certainly be done with good planning. This is called a “gift of residual interest”.

The University would have to agree to accept and hold the property for Roger’s lifetime. It would then become the landlord and assume full responsibility of ownership including income from rents. Roger would retain a life interest in his apartment with utilities included. The appraised value of the real property was \$3,000,000. The present value of his life interest was appraised at \$100,000. Roger’s modest lifestyle does not take him into the top tax brackets. Even though he has a significant stock portfolio as well, he withdraws very little as income. If he donates the building will he be able to use all of the tax credit from the donation receipt? Lets see.

Roger and May had crystallized their capital gain in 1993, but the property value had grown substantially since then, resulting in a further gain of \$1,500,000. About one fifth of that gain was attributable to his primary residence and therefore not taxable. He would have

to take 50% of the balance into income resulting in a big tax bill for one year and then back to normal. His charitable tax credit would easily wash taxes on 75% of his taxable income in the year of the donation and the unused balance can be carried forward for 5 more years. But Roger’s accountant calculated that he could only use about \$850,000 in tax credits over the allowable 6 years, which would result in about \$480,000 left over as non-refundable tax credit. How do we improve this position?

The residual interest gift agreement was designed with a twist that improved his position further. His accountant recommended that Roger should hold back a mortgage of \$1,500,000 in favour of the University requiring no payments, 0% interest and maturing in 6 years. The present value of this mortgage was about \$1,100,000 which, as an advantage to Roger, reduced the eligible donation amount to \$1,800,000. The resulting tax credit for a donation of this value would be entirely used up within 6 years.

He could choose to donate the mortgage anytime for its appraised value. In six years Roger would realize a capital gain of \$400,000 if he donates the mortgage when it matures. Again the donation tax credit would more than offset the taxable gain and the balance carried forward.

This plan effectively spreads out the tax receipt over 11 years. He could use the tax credit sooner if he wanted to cash in some of his appreciated stocks. In his Will, Roger arranged to donate the mortgage if it was still registered against the title.

This donation of property from a modest and generous Canadian would result in a very significant gift and a beautiful memorial for both Roger and May.

What does a gift of real property mean?

The act of donating should bring you great satisfaction. We want you to feel that a donation is a sound investment in the future of Carleton University. But even more importantly, we want you to know that your gift will enhance the opportunities for higher education at a level that is impossible without philanthropy. While tax dollars support important public programs and infrastructure, you may share the belief that donating these assets to the University will have more positive and lasting benefits to society than taxes.

References:

¹ Income Tax Folio S7-F1-C1, Split-receipting and Deemed Fair Market Value

² Interpretation Bulletin IT 226R

³ Subsection 118.1(6) Income Tax Act

⁴ Income Tax Technical News No. 7 1996

⁵ Subsection 104(21) Income tax Act

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