The Institute for Advanced Financial Education™

COMMENT

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TESTAMENTARY GIFT PLANNING

Charitable gift planning is a part of many estate plans. A testamentary gift could be as simple as a bequest of cash or could involve a more sophisticated strategy. From an income tax perspective, a testamentary gift is made the moment the gift or property is transferred to the charity. The gift could be direct from the estate or may arise from a beneficiary's right under a life insurance policy, RRSP, RRIF, or TFSA.

Final Return

Gifts made by the deceased or the deceased's spouse or common-law partner in the year of death may be claimed by the executor on the deceased's final return for an amount up to 100 percent of the deceased's net income in the year of death.

To the extent that either the deceased or the deceased's spouse or common-law partner made a gift in a prior year but within the five-year carry forward period, any unclaimed portion of the gift may be claimed on the deceased's final return for an amount up to 100 percent of the deceased's net income.

While it has been the Canada Revenue Agency's (CRA) administrative policy to allow spouses and common-law partners to pool gifts and claim on one return, this is now specifically mentioned in the *Income Tax Act*, as described above.

Graduate Rate Estate

Below is a summary of how the donation tax credit may be used for gifts made through a will or estate, while the testator's estate qualifies as a graduate rate estate (GRE), and when a gift is made by a direct beneficiary designation under a life insurance policy, RRSP, RRIF, or TFSA. An estate may qualify for GRE status for up to 36 months following an individual's death.

a. The gift may be claimed by the executor on the deceased's final return for an amount up to 100 percent of the deceased's net income in the year of death.

b. The gift may be claimed by the executor on the deceased's return for the year preceding death for an amount up to 100 percent of the deceased's net income for that particular year.

c. The gift may be claimed on the estate's tax return for the tax year in which the gift was completed. In this case, the amount of the donation claimed is limited to 75 percent of the estate's net income for that particular year.

d. The gift may be claimed on the estate's return in any of the five subsequent taxation years for an amount up to 75 percent of the estate's net income for the year it is claimed. This means that gifts made in the third year of the estate's GRE status may be claimed by the estate in the subsequent years when the estate no longer qualifies as a GRE.

e. A gift may be carried back to a preceding year of the estate. Aggregate gifts for that year are limited to 75 percent of the estate's net income.

Gifts that occur through a beneficiary designation must be completed during the existence of the GRE and must have occurred as a consequence of the deceased's death. If a gift is completed by an estate after its GRE status has expired, but within 60 months of deceased's death, the executor may claim the donation as outlined in (a) through (d) above. These options are available only if the estate remains in existence.

Planning Ideas

A testamentary charitable gift may be completed through a cash payment to the charitable entity or could be designed as a gift-in-kind.

It is common for a will to provide instructions that direct the executor to complete a particular gift or to provide latitude for the executor to determine how best to fulfil a charitable bequest. By providing this flexibility, an executor may determine the optimal distribution taking into account all assets owned at the time of death, the charitable objective, liquidity of the estate, amounts owing to all beneficiaries of the estate, and the income tax consequences.

Publicly traded securities are afforded special income tax treatment when donated as a gift-in-kind. In this case, there is no realization of a taxable capital gain, but the estate still receives a charitable donation receipt for the fair market value of the securities. By donating the shares as a gift-in-kind, the executor can achieve a more efficient result for the estate when compared with disposing of the shares, paying the tax, and then donating the after-tax cash to the same charity.

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Consider the example of Sam who passes away owning an investment portfolio valued at $1,000,000 with an adjusted cost base of $750,000. Sam's executor would report a $250,000 capital gain ($1,000,000 less $750,000) on Sam's final tax return. Assuming a 50 percent marginal tax rate, Sam's estate would incur an income tax liability of $62,500 on the taxable capital gain arising from the deemed disposition.

Assume that Sam wanted to make a $1,000,000 donation to his favourite charity. If Sam's instructions in the will provide for a donation of the shares to the charity or provided the executor with the authority to complete the bequest with a gift-in-kind, the estate would save $62,500 in income taxes.

In either scenario, a cash donation of $1,000,000 or a gift-in-kind of the shares valued at $1,000,000, the estate is entitled to a charitable tax receipt of $1,000,000. If the $1,000,000 of cash required to fulfil the bequest is achieved through the actual disposition of the shares, the estate would have a tax bill of $62,500 and would need to supplement the donation with other liquid assets to complete the $1,000,000 gift (disposition of shares resulted in liquidity of $937,500). If the bequest is fulfilled as a gift-in-kind, the executor would refile Sam's final tax return to remove the $250,000 capital gain, as the gift-in-kind attracts a zero income inclusion rate and would provide for the return of $62,500 through a reduced income tax liability.

Life insurance can be integral to a variety of charitable gift planning strategies. Some individuals purchase life insurance because it allows them to make a charitable bequest without depleting their estate's assets. Others use life insurance to magnify the size of a charitable gift.

A common charitable strategy is to gift a new or existing life insurance policy to a charity, whereby the charity becomes the owner and beneficiary of the policy. The charity can generally issue a charitable receipt for the fair market value of the policy at the time the policy is transferred and for any premiums paid by the donor on behalf of the charity after the transfer. As beneficiary of the policy, the charity receives the death benefit paid at the time of the life insured's death.

Consider the example of Martha who owns a life insurance policy on her life that she no longer requires as part of her estate plan. Rather than surrender the contract, Martha could donate the contract to her favourite charity. She would receive a tax receipt from the charity for the fair market value of the policy at the time of transfer and any future premiums she might pay towards the policy. Martha would also incur a tax liability if the cash surrender value of the policy exceeded its adjusted cost basis at the time of the gift. Typically, the savings generated from the donation will more than compensate for this liability, but is nonetheless a factor that should be considered at the planning stage.

Upon Martha's passing, the charity would receive the insurance proceeds as the beneficiary of the policy. Since Martha relinquished ownership of the policy, her estate is not entitled to any of the proceeds nor a receipt for the proceeds of the insurance paid to the charity.

Another charitable gift planning strategy using life insurance involves an individual retaining ownership of an insurance policy but naming a charity as the beneficiary for all or a portion of the death proceeds. At the time of the individual's death, the charity will issue a charitable receipt for the value of the proceeds received as a beneficiary of the policy. In addition to addressing an individual's charitable objectives, this strategy can be useful when individuals anticipate a large income tax liability upon their death and opt to use a charitable gift to offset some or all their income tax liability.

Consider the example of Matthew and Marisa who jointly own a joint last-to-die life insurance policy on their lives. The couple have decided to use the policy for the benefit of their favourite charity. Matthew and Marisa could name the charity as beneficiary of the policy, while retaining ownership.

Given that the couple continue to retain ownership of the policy, they will not receive any charitable receipts during their lifetime. However, upon the later death of Matthew and Marisa, the charity would receive the insurance proceeds and the estate of the last-to-die would be entitled to a charitable receipt equal to the insurance proceeds. The charitable tax receipt will generate a charitable tax credit that, as intended in their estate plan, will offset the income tax liability arising on the death of the last-to-die. Under this strategy, the charity would have to receive the proceeds of the life insurance policy during the period when the GRE existed in respect of the last-to-die.

The benefits of testamentary charitable gift planning can be rewarding for both the donor and the charity that receives the benefit of a testamentary gift. There is no single strategy that applies across all donors, but plans can be designed to address an individual's personal and financial objectives.

TAX FILING SEASON: A LOOK BACK AND AHEAD

Looking back to the 2017 income tax filing season, it is interesting to observe, as shown in the chart below, that 87 percent of all income tax returns were filed electronically. Of the 26 million returns filed electronically, about 65 percent were prepared by someone other than the taxpayer.

The CRA offers an online portal through which individuals can enter data and file their return directly on the CRA's website. Just over 47,000 individuals, representing a fraction of one percent of all filers, opted to use this service. While electronic filing is certainly the norm, there is a surprisingly high number of individuals, at 3.9 million representing 13 percent of all returns, who continue to file manually.

Thinking Ahead

As individuals begin to think about the 2018 tax filing season, below are some tips for preparing for the upcoming season.

File on time: Filing on time will avoid unnecessary interest and penalties. Missing the filing deadline results in a penalty of 5 percent of the balance owing plus interest at the rate of 6 percent (prescribed rate plus 4 percent) based on every whole month on the outstanding balance. Even when individuals do not have the funds to pay their outstanding income tax liability, filing on time will at least avoid a late filing penalty.

Review last year's return and assessment: A review of the taxpayer's notice of assessment for the prior year will yield some valuable information such as RRSP contribution room, RRSP deduction room, loss carry-forwards, and unused tuition carry-forwards.

Review medical expenses: Medical expenses incurred, but not previously claimed, can be grouped into any 12-month period ending in 2018 and claimed as a non-refundable medical expense credit if the total exceeds a minimum threshold. The 2018 threshold is the lesser of 3 percent of the taxpayer's net income and $2,302.

Autofill My Return: Individuals and tax preparers who use net file certified tax preparation software and who have registered for My Account with the CRA will have the opportunity to auto-fill their 2018 tax return. All T-slips, which have been filed with the CRA, will automatically pre-populate the individual's tax return. The advantage of using this feature is that missing T-slips will be identified, and the individual will know what the CRA is expecting and can deal with any discrepancies.

Principal Residence: The disposition of a principal residence must be reported on the individual or couple's tax returns for the year of disposition. While the gain may be completely offset through the claim for the principal residence exemption, the gain and offsetting deduction must still be reported.

Review pension splitting options: Eligible couples are permitted to income split up to 50 percent of eligible pension income through an annual elective procedure that requires the completion of a form T1032. In general terms, eligible individuals include those age 65 or older with eligible pension income from a registered pension plan, registered annuity, or RRIF. Individuals under age 65 are subject to a more restrictive definition of eligible pension income that includes payments from a registered pension plan, registered annuity or RRIF arising as a consequence of the death of a spouse. Generally, couples would elect to split pension income when their combined tax liability through income shifting is lower than without using this option.

Remember Foreign Reporting: Taxpayers who own certain specified foreign property with an aggregate cost of more than $100,000 (Canadian) must file form T1135 and make the appropriate disclosure with their income tax return.

How Taxpayers Filed	# of returns	As a %
EFILE; where a provider prepares the return and files electronically with CRA	17,043,537	57.3%
NETFILE; where an individual prepares their return and files electronically with CRA	8,741,893	29.4%
File my Return (FMR) is a service provided by CRA where an individual prepares their tax return on the CRA website electronically	47,196	0.1%
Paper; where an individual completes their return on the paper forms provided by the CRA	3,920 623	13.2%
TOTAL	**29,753,249**	**100%**

BENEFITS AND CONTRIBUTIONS FOR 2019

Contributions and benefits under government pension plans are periodically adjusted to reflect increases in the Consumer Price Index or the average Canadian wage. The new amounts, effective January 1, 2019, are shown in the table below. Each benefit is subject to income tax when received, with the exception of the Guaranteed Income Supplement and the Allowance. All benefits shown are paid monthly unless otherwise indicated and are the maximum amounts.

	CPP	QPP	OAS
CPP / QPP Benefits (for new beneficiaries)			
Retirement pension (at age 65) Post-Retirement benefit (at age 65) Retirement Pension Supplement	$1,154.58 $28.86 n/a	$1,154.58 n/a $21.83	
Disability pension	$1,362.30	$1,362.27	
Disabled contributor's child benefit (each child)	$250.87*	$79.46*	
Survivor's *** pension			
• Under age 65	$626.63**	$931.43**	
• Age 65 and over	$692.75	$696.15	
Surviving child's benefit (each child)	$250.27*	$250.27*	
Death Benefit (lump sum)	$2,500.00	$2,500.00	
Annual CPP Contribution			
Employee's Annual contribution (5.1%)	$2,748.90		
Employer's matching of employee's contribution (5.1%)	$2,748.90		
Self Employed's Annual contribution (10.2%)	$5,497.80		
Annual QPP Contribution			
Employee's Annual contribution (5.55%)		$2,910.60	
Employer's matching of employee's contribution (5.11%)		$2,910.60	
Self Employed's Annual contribution (11.1%)		$5,821.20	
Old Age Security (OAS)			
January to March 2019			$601.45
Guaranteed Income Supplement (GIS)			
January to March 2019			
Spouse/common law partner receives OAS or Allowance			$540.77
Single person (or spouse/common law partner receives neither OAS or Allowance)			$898.32
Allowance			
Age 60 to 64 and spouse/common law partner receives OAS and GIS			$1,142.22
Age 60 to 64, survivor's*** Allowance			$1,361.56

Notes: * flat benefit amounts ** these amounts may vary depending on whether the survivor is under 45, disabled, or with or without children *** a survivor is the spouse or common-law partner of a deceased individual.

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