

# **Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust**

IT226R

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NO: **IT-226R**

DATE: November 29, 1991

SUBJECT: INCOME TAX ACT

**Gift to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust**

REFERENCE: Subsections 110.1(1) and 118.1(3) (also sections 43 and 70, subsections 118.1(1), (5) and (6), and subparagraph 69(1)(b)(ii) of the Act and Part XXXV of the Regulations)

Application

This bulletin cancels and replaces Interpretation Bulletin IT-226 dated June 2, 1975.

Summary

This bulletin discusses the requirements that must be met for an inter vivos or testamentary donation of a residual interest in real property or an equitable interest in a trust to qualify as a gift for purposes of the Act. The bulletin also comments on the valuation of a residual or equitable interest and provides a formula to calculate the adjusted cost base of a residual or equitable interest in respect of a capital property.

Discussion and Interpretation

1. A gift of a residual interest in real property or an equitable interest in a trust to a registered charity or certain other organizations (described in subsection 110.1(1) or 118.1(1)) may qualify as a deduction in computing taxable income, if donated by a corporation, or as a non-refundable federal tax credit, if donated by an individual. Subsection 110.1(1) provides the deduction for corporations and subsection 118.1(3) provides the tax credit for individuals. Prior to 1988, charitable gifts, whether made by a corporation or an individual, were allowed as a deduction in computing the taxable income of the donor.
2. A particular donation must qualify as a gift in order for the provisions of subsections 110.1(1) and 118.1(3) to apply. For the purposes of these provisions, a gift is a voluntary transfer of real or personal property without valuable consideration. There must be a donor with the capacity to make the gift and there must be a donee to receive the property donated. Where the property donated consists of a residual interest in real property or an equitable interest in a trust, the Department will consider a gift to have been made if all of the requirements listed below are met.
  - (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.

(b) The property must vest with the recipient organization at the time of transfer. A gift is vested if

(i) the person or persons entitled to the gift are in existence and are ascertained,

(ii) the size of the beneficiaries' interests are ascertained, and

(iii) any conditions attached to the gift are 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.

Once it is established that a gift has been made, the value of the gift at the time of the transfer must be determined before it can be claimed for income tax purposes (see 5 below). Also, the gift must be supported by an official donation receipt issued in accordance with Part XXXV of the Regulations (refer to the current version of IT-110, Deductible Gifts and Official Donation Receipts).

3. An equitable interest in a trust is created upon the transfer of any property (including real property) to a trust with the requirement that the property be distributed to a beneficiary at some future date (e.g. when an income interest of another person ends). Where such an interest is created for the benefit of a charity, that interest may qualify as a gift for the purposes of subsection 110.1(1) or 118.1(3).

A gift of an equitable interest could be made through a testamentary trust or an inter vivos trust. For example, assume that a trust is created by the will of a deceased taxpayer to hold property gifted by the deceased to a registered charity. The terms of the will require the trustees to pay all of the income earned by the trust to the taxpayer's surviving spouse and, on the death of the taxpayer's spouse, to transfer the property to the registered charity. Neither the spouse nor any other person has the power to encroach on the capital of the trust. In this case, a testamentary gift of an equitable interest in a trust is considered to have been made and the taxpayer is deemed by subsection 118.1(5) to have made a gift of the interest to the registered charity in the taxation year in which the taxpayer died. On the other hand, an example of an inter vivos gift of an equitable interest in a trust is where a taxpayer transfers a property to a trust and the trustee is instructed to pay all of the income earned by the trust to the taxpayer during the taxpayer's lifetime and, on the death of the taxpayer, to transfer the property to a registered charity. If all of the requirements listed in 2 above were satisfied at the time of the transfer to the trust, an inter vivos gift of an equitable interest in a trust is considered to have been made at that time.

4. In the case of an equitable interest in a trust, the Department considers a gift to have been made when the transfer of property to the trust has been completed and the equitable interest in the trust has vested in the charity. Where the trust property consists of personal property such as paintings, sculptures or other moveable articles, the location or

possession of the trust property may, because of its nature, be changed with relative ease. In order to satisfy the requirements of 2(c) and (d) above, necessary precautions must be taken to ensure that the charity's ownership of the interest is protected until the actual transfer and distribution of the property occurs.

5. The method of valuing a residual interest in real property or an equitable interest in a trust, whether it be for the purpose of determining the amount of a charitable donation or other tax consequences, will vary according to the type of gift, other interests in the property or trust and the documentation providing for the gift. The general approach is to value the various interests 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. In the case of property other than real property, the longer the period before full ownership of the property is passed to the charity, the more difficult it is to establish its value.

6. In cases where the size of a residual or equitable interest at the time of the donation cannot reasonably be determined, such as when a life tenant or trustee has a right to encroach on the capital of the trust, no deduction or tax credit in respect of the donation will be allowed.

7. A gift of property that is capital property of the donor will normally give rise to a capital gain or loss. Where the property disposed of is a residual interest in real property, the part disposition rules in section 43 require that a reasonable portion of the adjusted cost base of the total property immediately before the disposition must be attributed to the residual interest in computing the resulting capital gain or loss. When the value of the residual interest and all other interests at the time of the vesting of the gift have been determined, the adjusted cost base (ACB) of the residual interest can be calculated as follows:

A = Fair Market Value of Residual Interest

B = Fair Market Value of All Interests in the Property

C = ACB of Total Property

D = ACB of Residual Interest

$(A \div B) \times C = D$

8. As a general rule, where a taxpayer disposes of a capital property to an inter vivos trust for the benefit of a charity, the taxpayer is deemed to have received proceeds of disposition equal to the fair market value of the property pursuant to subparagraph 69(1)(b)(ii). Where the property is disposed of to a testamentary trust, the rules in section 70 apply. In either case, if the fair market value of the property at the time of disposition exceeds its adjusted cost base, the taxpayer or the taxpayer's legal representative, as the case may be, will be eligible to make the election provided for under subsection 118.1(6).

This subsection provides rules allowing for an elected amount, not greater than the fair market value and not less than the adjusted cost base of the capital property, to be considered as both the proceeds of disposition and the amount of the gift.

9. For additional information on charitable donations, refer to the current versions of the following bulletins:

- IT-111      Annuities Purchased from Charitable Organizations
- IT-244      Gifts of life insurance policies as charitable donations
- IT-288      Gifts of Capital Properties to a Charity and Others
- IT-297      Gifts in Kind to Charity and Others
- IT-504      Visual Artists and Writers