Welcome news for the charitable sector in federal budget 2015

On 21 April 2015, federal Finance Minister Joe Oliver tabled his first federal budget. The budget contains welcome measures that the charitable sector has advocated for some time.

Taxpayers planning to donate portions of their business or real estate sale proceeds to charity will be particularly pleased with the capital gains exemption proposed in Budget 2015. In addition, changes that will permit charities to now hold certain limited partnership investments will allow them to diversify their portfolios and hold innovative types of social impact investments.

Below, we discuss the charity-related measures contained in Budget 2015.

Donations related to the disposition of private corporation shares or real estate

Under the current rules, a gain realized on the donation of shares of publicly traded corporations to a qualified donee is exempt from capital gains tax. This capital gains exemption also applies to other listed securities, shares or units of mutual funds, and other eligible securities. However, for various reasons, including valuation-related concerns, this exemption does not cover the donation of private corporation shares or real estate.

Based on a 2013 report recommendation from the House of Commons Standing Committee on Finance,¹ Budget 2015 proposes to introduce a capital gains exemption where proceeds from the disposition of private corporation shares or

¹ Tax Incentives for Charitable Giving in Canada, report of the House of Commons Standing Committee on Finance, February 2013, recommendation no. 1, p. 27.
real estate (rather than the shares or the real estate themselves) are donated to a qualified donee. The exempt portion of the capital gain will be prorated based on the proportion of the donated proceeds to the total proceeds from the sale of the shares or real estate.

To benefit from this new exemption, the following conditions must be met:

- Cash proceeds from the disposition must be donated to the qualified donee
- The gift must be made within 30 days after the disposition of the shares or real estate
- The shares or real estate must be sold to a purchaser that is dealing at arm’s length with both the donor and the qualified donee
- The disposition must occur after 2016

In addition, several anti-avoidance rules will apply. Specifically, within five years after the disposition:

- The donor (or a person not dealing at arm’s length with the donor) cannot directly or indirectly reacquire any property that had been sold
- In the case of shares, the donor (or a person not dealing at arm’s length with the donor) cannot acquire substituted shares
- In the case of shares, the shares sold cannot be redeemed if the donor does not deal at arm’s length with the corporation at the time of the redemption

Where any of these three anti-avoidance rules apply, the capital gains exemption will be reversed by including the previously exempted amount in the donor’s income in the year of the re-acquisition by the donor (or the non-arm’s-length person) or the redemption.

**Benefit to donors**

The proposed broadening of the existing capital gains exemption reduces the tax cost of disposing of private corporation shares or real estate, while the donor continues to benefit from a full donation tax credit for the donated proceeds.

For example, an individual resident in Ontario who donates $1 million of proceeds received from the sale of private company shares or real estate would, under current rules, pay capital gains tax of approximately $248,000 (assuming the cost of the donated property is negligible). Donating the after-tax proceeds of $752,000 to a charity will result in a tax credit worth approximately $349,000 in tax savings to the donor. After taking into account the benefit of the donation tax credit, the gift effectively costs the donor $651,000, but the charity only receives $752,000.

Under the proposed rules, if the same individual donates $1 million of proceeds from the sale of the private company shares of real estate to a charity, there will be no capital gains tax payable and, further, the donor will be entitled to claim a donation tax credit of approximately $464,000. In this situation, the cost of making the gift is $536,000 and the charity receives cash of $1 million.

The benefit of the change is twofold: the charity receives additional funding of $248,000, and the cost of the gift to the donor is $115,000 lower under the proposed rules than under the current regime.

Donors will have to make sure, however, that they comply with the conditions to obtain the exemption and the anti-avoidance rules during the first five years after the disposition. It should be noted that the relief provided by Budget 2015 is limited to the capital gains exemption; it does not cover any potential recaptured depreciation that is included in income in connection with dispositions of real estate.

**Benefit to charities**

The proposed broadening of the existing capital gains exemption should increase the support for charities because donors should have more money available to donate. Charities will not need to address the complexities of valuing...
donated private corporation shares or real estate, or assume the risks associated with holding such types of property directly.

Although the changes should be well received, charities and other qualified donees will have to wait until 2017 to see the benefits of the proposed change materialize. Charities may wish to begin to promote these types of donations within their donor base.

**Investments in limited partnerships**

Under the current rules, private foundations are prohibited from carrying on any business. Charitable organizations and public foundations may only carry on a business that is considered a “related business”, one that is either related to their charitable purposes or staffed by volunteers. Since by definition and under provincial law partners in a partnership are considered to carry on the business of the partnership, private foundations are prevented from investing in partnerships, and charitable organizations and public foundations are restricted in making such investments.

Budget 2015 proposes amendments to allow registered charities and registered Canadian amateur athletic associations (RCAAAs) to invest in limited partnerships. Registered charities and RCAAAs will no longer be considered to carry on a business, and thus put their charitable status in jeopardy, solely because of acquiring or holding an interest in such partnerships.

These passive investments in limited partnerships will be allowed subject to the following three conditions:

- The registered charity (or RCAA), together with all non-arm’s-length entities (i.e., persons and partnerships), holds a maximum of 20% of the fair market value of the interests in the partnership
- The registered charity (or RCAA) is dealing at arm’s length with each general partner of the partnership
- The investment in the limited partnership is made or acquired after 20 April 2015

These conditions would not, however, apply where a charitable organization or public foundation carries on a related business through a limited partnership.

In addition, consequential amendments will also be made so that the existing excess corporate holding rules, which place limits on shareholding by private foundations, will look through limited partnerships. The non-qualifying security rules and the loanback rules will also be extended to apply to donations of interests in limited partnerships.

**Benefit to charities**

This change, advocated for some time by the charitable sector, will allow registered charities (and RCAAAs) to access a wider range of investment opportunities and diversify their investment portfolios. In addition, these organizations will now be able to accept in-kind donations of limited partnership units from donors, subject to the conditions described above.

It is particularly important and relevant to private foundations seeking to diversify their investment portfolios, given the current prohibition from investing in partnerships. A further benefit of the proposed change is that charities will no longer be precluded from investing in entities structured as limited partnerships created to address certain social and economic needs.

**Gifts to foreign charitable foundations**

Budget 2015 proposes to allow foreign charitable foundations to apply for qualified donee status under the same conditions as currently available for foreign charitable organizations. The Minister of National Revenue may grant qualified donee status, for a 24-month period, if the foreign charity receives a gift from the Government of Canada, and is either:
Carrying on relief activities in response to a disaster;
Providing urgent humanitarian aid; or
Carrying on activities in the national interest of Canada.

Foreign charitable foundations registered under this extended new measure will be included on the list of registered foreign charities maintained on the Canada Revenue Agency’s (CRA’s) website and will be able to issue donation receipts to Canadian donors that they can use in Canada. Further, Canadian-registered charities will be permitted to provide gifts to registered foreign foundations without risk to their own charitable status.

This measure will be applicable on Royal Assent of the enacting legislation.

**Benefit to charities and donors**

This proposed measure will broaden the number and scope of entities to which both Canadian charities and donors may make donations.

**Learn more**

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