THE CALGARY FOUNDATION
FOR CALGARY FOREVER

Achieving philanthropic goals for your clients

Advice for **Advisors**

APRIL 2013

Advisors

Giving Options for Your Clients

Cost Recovery (Annual)

Investment Overview

Discussing Charitable Giving

Endowment Calculator

Advisor FAQs

A Perfect Storm

2 Opportunity One: Insurance that has lost its original purpose

3 Opportunity Two: Elimination of the 80% disbursement quota for charities

4 Illustration One: Gift of existing insurance through Holding Company

5 Illustration Two: Estate planning using ACB Pipeline

6 Illustration Three: Estate planning using a Foundation "Pipeline"

7 Illustration Four: Private Foundation "Pipeline"

8 Value of Donating Publicly Listed Flow-Through Limited Partnerships

Advice for **Advisors** is for professionals working in the financial planning, insurance, estate and tax accounting, Wills and estates law, investment planning and wealth management fields. This publication provides authoritative information on the topic of philanthropy and highlights The Calgary Foundation's expertise in charitable and planned giving.

Introduction

by **Laily Pirbhai**, VP Donor Engagement, The Calgary Foundation

In the last decade, many studies have attempted to quantify the magnitude of the wealth that will transfer between generations. In Canada, it has been estimated that Boomers stand to inherit approximately $1 trillion over the next 20 years. While the size of the pie is up for debate and continues to be influenced by market conditions and other factors, there are strategies that Canadian families can take to help achieve their inheritance vision and to maximize the intergenerational transfer of wealth.

Communication with advance planning is key. For some, proactively initiating a family conversation on the transfer of wealth may seem daunting, however, the risk of not doing so is likely to have far worse consequences. We, at The Calgary Foundation, share these examples in the hope of partnering with you towards supporting your client's charitable work. By making the giving process easier, you are not only working for your clients, you are working for the community too. At the end of the day, we think that's the best kind of work there is.

A **"Perfect Storm"** of Planned Gift Opportunity for Advisors with High Net Worth Clients

by **DeWayne Osborn**

Over the past five years, there has been a series of significant legislative events that I would call the *perfect storm of opportunity* for your high net worth clients to make a significant charitable gift to their favorite charity. While legislative changes alone should never be sufficient grounds for any charitable gift, for a philanthropically-inclined client that is facing certain financial situations at this stage in their life, a little pre-planning can save hundreds of thousands of dollars of taxation while making their philanthropic dreams come true.

So what is the perfect storm of legislative events? The series of legislative events began in 2007 when Finance released a position that insurance policies may be gifted at fair market value or cash surrender value. Up until that time, the accepted method for valuing a gift of life insurance was to use the cash surrender value as the basis of the gift. The cash surrender value roughly represented the amount of cash in the policy that the owner could extract at any time. Such a position made sense for charities because it was administratively simple to determine the value of the gift, and in the worst case, the charity could collapse the policy and receive the cash held within it.

Opportunity One: Insurance that has lost its original purpose

Insurance can be purchased for many reasons, and sometimes the original purpose of the insurance changes over the lifetime of the owner/donor. Quite often this change in purpose occurs at the death of a spouse. Prior 2007, many policies would simply lapse because there was no ability to donate them due to the fact that some contracts did not have cash surrender value and were not attractive to charities.[1]

For example, Term to 100 contracts guaranteed to pay a death benefit provided a ongoing premium obligation is met until the death of the insured. This is the least expensive form of insurance because the owner of the contract is basically paying the minimum premium required to sustain the policy. Unfortunately, there is no cash in the policy. Post-2007, even zero cash surrender value policies can have substantial fair market value that can be reasonably determined through use of an actuary with knowledge and experience in the valuation of life insurance contracts.

Example One: gift of Term to 100 insurance

Factors	
Current Age of Donor	83
Type of Policy	Term to 100
Annual Premium	$1,250 for life
Death Benefit	$250,000
CSV	$0
FMV (pre 2007)	$0
FMV (post 2007)	$134,000
Tax Savings (AB@50%)	$67,000
Return on Investment†	**24%**

Notes: †donor's life to age 100

Bill, age 83, was able to gift property that had lost its original value to him (Term to 100 life policy with no cash surrender value) to his favorite charity and received $134,000 tax receipt thus saving him **$67,000 in taxes**. What was the catch? When the actuary made the fair market value determination, the charity had to *guarantee the premiums* would be paid (actually the charity found another donor to make the donations to pay the premiums). Why would a charity agree to guarantee the ongoing premium in this scenario? The advisor showed them the 24% rate of return required for a $1,250 annual investment to generate a guaranteed quarter million dollars in 17 years (age 100 of the donor). **What other investment could charity find that would generate such a return?**

This simple scenario illustrates two fundamental changes that came together to help this donor and charity. The first was the acceptance of a fair market value that could be far different than the previously established cash surrender value. Secondly, a charity was prepared to view an annual premium obligation as an investment and to measure that financial soundness of such a strategy using industry-standard rate of return calculations.

A WORD OF CAUTION: it would be rare to find a charity that is prepared to view such an investment in this manner. Therefore as an advisor, if you wish to pursue a similar strategy, you should consult with the recipient charity well in advance to resolve any issues or concerns that may arise.

1 Prior to 2007, cash surrender value was the basis of determining the fair market value of a donation to charity.

Opportunity Two: Elimination of the 80% disbursement quota for charities

The second significant gift opportunity occurred on March 4, 2010 when Finance removed the requirement that charities had to spend a significant portion of the amount they issued tax receipts for in the previous year[2]. This annual spending requirement is referred to as the disbursement quota ("DQ"), and failure to pay the DQ is cause for revocation of the charity's registered charitable status.

Example Two: Impact of the removal of the 80% disbursement quota requirement

Factors	Gift Amount $$	DQ Prior to March 4, 2010	DQ After March 4, 2010
Total Cash Gifts†	$200,000	$160,000	$0
Gift of Insurance	$134,000	$107,200 (80% X $134,000)	$0
Actual Cash Received	$200,000	$200,000	$200,000
Spending Required††	NA	$267,200	$0
DQ Surplus (Shortfall)†††	NA	($67,200)	$200,000

NOTES: † *the total amount of tax receipted donations to the charity in the year. Assume charity will spend all of it in the next year.*

†† *Add the DQ columns: Total Cash Gifts + Gift of Insurance.*

††† *Actual Cash Received – Total Spending Requirement.*

If you use the illustration above and the gift occurred prior to March 4, 2010, the recipient charity would have had to spend $107,200 ($134,000 x 80%) on its charitable activities in the next year. Such a requirement would have been problematic in this case because the charity was small and did not receive cash to spend on its charitable activities. However after March 4, 2010, the pressure on the charity to disburse cash it did not have was relieved. By uncoupling the disbursement quota from the value of the tax receipt issued, Finance has allowed substantial gifts to occur without disbursement quota consequence. **This factor will be particularly important in the discussion to come on private foundations.**

2 Prior to that legislation, a charity was required to spend 80% of the value of receipts it issued in the previous year in order to maintain its registered charity status

Illustrations

To sum up, these two profound legislative changes have set the stage for significant charitable gifts from property that would have previously been overlooked or ignored. In the proper environment and in certain client situations, *significant tax savings* may be generated where none was possible before.

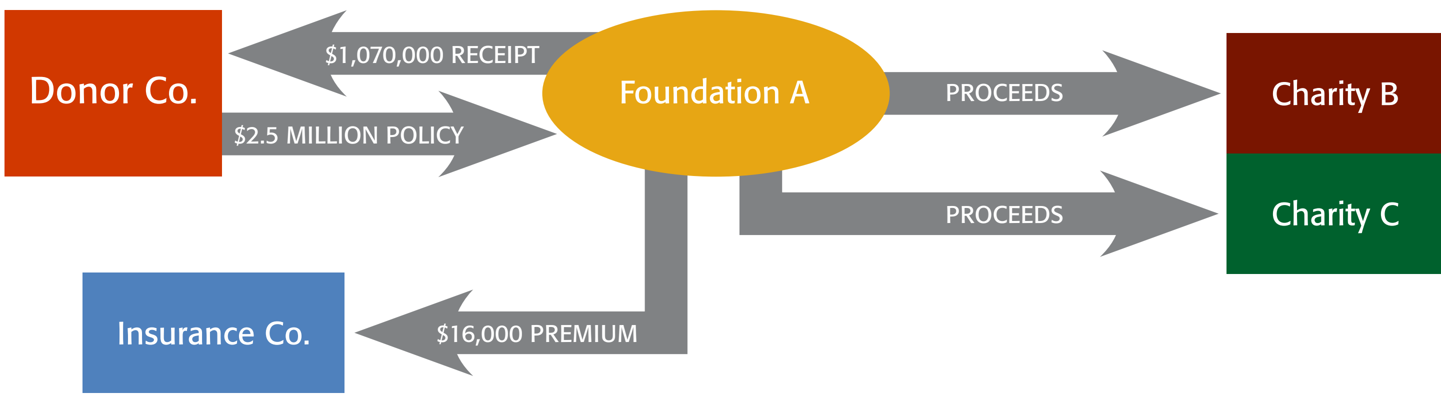
What types of situations am I referring to? Over the past year, there seems to be an increasing number of high net worth clients undergoing substantial life changes. An example of such a change would be the selling of their business, retirement, selling off of assets no longer needed (e.g. cottages), loss of a spouse, and so forth. These situations often generate significant tax issues for the high net worth client, as well as situations where they philanthropically inclined client can address some or all of the tax issues by using charitable gifting.

Illustration One: Gift of Existing Insurance Through Holding Company

Here is another real world situation that might be applicable in your client base. The client is a 72-year-old recent widower living in Manitoba that has several holding companies and other commonly used tax structures. As with many high net worth clients, he also has several life insurance contracts owned both personally and corporately. The client has been making charitable donations for years.

Recently, the client had sold some of the corporately owned leisure property and had incurred significant capital gain that would be subject to $300,000 in taxation. He also felt that he no longer needed one of the corporately owned life insurance contracts and was prepared to stop paying the premiums. The contract was a whole life policy that guaranteed to pay a death benefit of $2.5 million provided the $16,000 annual premium was paid. The premium was based on a guaranteed internal rate of return of 4% in the policy.

In discussion with his advisor, it was recommended that the client donate the policy to resolve the tax issue at hand AND to leave a significant gift to the *three* charities he had supported for decades. An actuary assessed the value of the contract at $1,070,000 on the condition that the recipient charities guarantee that the premiums would be paid.[3] By assigning this contract to Foundation A, the client eliminated the $300,000 in tax from the sale and had an additional $192,200 ($1,070,000 X 46% – $300,000) in tax savings to use in the current year OR over the next five years. Thanks to the DQ changes, Foundation A was able to issue the large receipt because it was not required to spend $856,000 in the next year ($1,070,000 X 80%) AND Foundation A agreed to pay 1/3 of the death proceeds received to Charities B and C. **A true win win scenario for all!**



3 Prior to 2007, the SMV of the gift would = the cash surrender value of $11,000.

Illustration Two: Estate Planning Using ACB Pipeline

A common estate planning problem facing high net worth business owners is how to tax effectively extract themselves from their ownership in the business. Based on a review of the strategies being promoted by tax advisors, the common themes seem to involve eliminating the tax on the capital gain, or eliminating the deemed dividend that occurs at time of the death of the shareholder.

If the philanthropically inclined client is comfortable with such levels of estate planning, there are opportunities to make significant gifts and avoid *both* taxes. Let us take a look at some common promoted strategies and adjust them for a charitable gift.

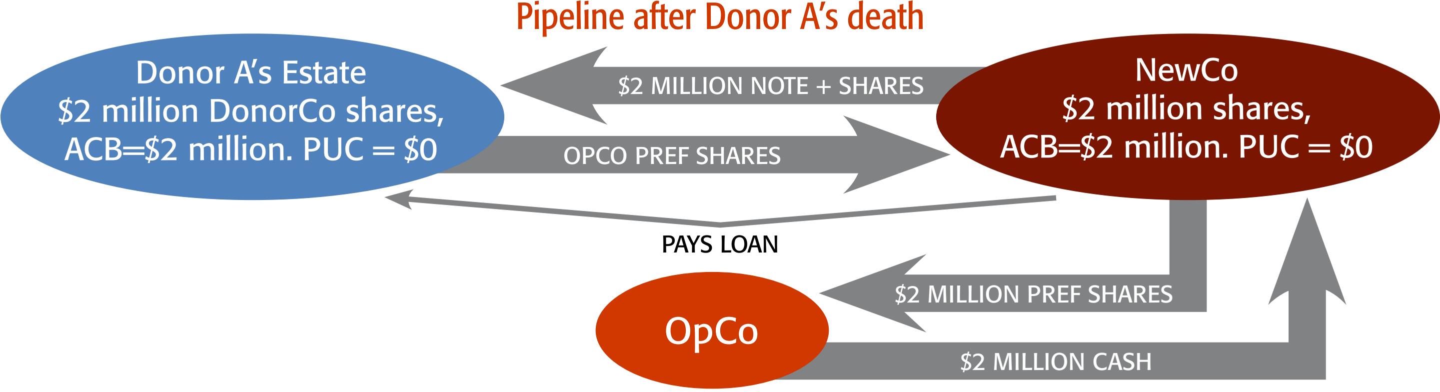
Fact pattern: Donor A is an uninsurable 75 year old widower. He is comfortable with relatively sophisticated tax planning and completed an estate freeze some time ago. He currently owns $2 million of preferred shares of OpCo with an adjusted cost base (ACB) and paid up capital (PUC) of nil. OpCo is owned by his kids. He has substantial other assets and his personal tax rate is 39% and his dividend rate is 28%. Donor A does not like to paying any more tax than absolutely necessary, and very recently he determined that his children were in no longer in need of money from his estate.

Donor A's advisor would like to discuss a strategy he has used many times before. The strategy is commonly known as the "ACB pipeline" and it is primarily designed to eliminate the deemed dividend when shares are redeemed by the company.[4]

Here is what he plans to propose to Donor A:

Facts	No Estate Planning	ACB Pipeline Strategy
FMV of Shares	$2 million	$2 million
ACB	$0	$0
PUC	$0	$0
Capital Gain	$2 million	$2 million
Deemed Dividend	$2 million	$0
Tax on Gain @ 39%	($390,000)	($390,000)
Dividend Tax @ 28%	($560,000)	$0
Total Tax Payable	**$950,000**	**$390,000**

Generally speaking, a new company will be formed (NewCo) from language in his Will. NewCo will purchase the OpCo preferred shares from his estate using a promissory note and nominal value shares. NewCo would own OpCo and the $2 million cash now in NewCo would be an tax free intercorporate dividend. Therefore the only tax Donor A will have to pay is on the $2 million capital gain, which should be $390,000 ($2 million X 19.5%). Before proceeding, the advisor will make sure that Donor A is comfortable with CRA's concern with regard to this strategy.[5]



4 The intent to this article is to not promote any particular planning strategy. Rather to encourage advisors to consider altering existing and well understood planning strategies to include charitable giving.

5 CRA has commented that removal of assets using this strategy could trigger ITA 84(2) thus making the dividend taxable. The final decision on the feasibility of this or any other tax avoidance strategy will ultimately rest with the courts.

Illustration Three: Estate Planning Using a Foundation "Pipeline"

During the meeting, Donor A realized two things: 1) that the size of the gifts he had left in his will many years ago were no longer sufficient to do what he wanted, and 2) he remembered that some foundations (e.g. Calgary Foundation) will accept private shares with a ready redemption strategy in place.

Facts	No Estate Planning	Foundation Pipeline Strategy
FMV of Shares	$2 million	$2 million
ACB	$0	$0
PUC	$0	$0
Capital Gain	$2 million	$2 million
Tax on Gain	($390,000)	($390,000)
Deemed Dividend	$2 million	$2 million
Dividend Tax	($560,000)	**$0**
Donation of Shares	**NA**	**$2 million**
Tax Credit from Gift†	**NA**	**$1 million**
Total Tax Payable††	**$950,000**	**$0**

NOTES: † $2 million X 50%

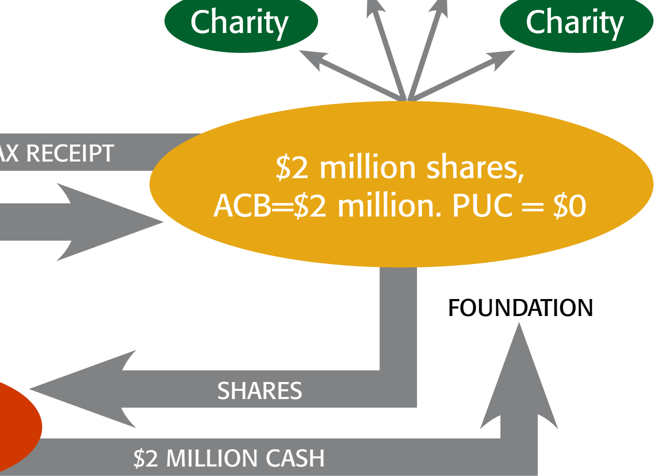
†† The tax credit eliminates the tax on the gain leaving $610,000 in tax savings for other income.

He mentions these two things to his advisor and they devised the following plan:

Instead of striking a NewCo, Donor A makes a bequest of all $2 million of his preferred shares to the Foundation.[6] The Foundation will issue a tax receipt for $2 million and the resulting tax credit will wipe out the $390,000 in tax on the capital gain, as well as allowing an additional $610,000 in tax savings to be extended to other income on Donor A's final tax return.[7] OpCo will redeem the shares from the Foundation, which will provide the $2 million in cash to be split amongst the four charities as per Donor A's written direction to the Foundation.[8] The Foundation does not pay tax on the deemed dividend.[9]

The end result, Donor A does not pay any tax on the disposition of his preferred shares AND the charities he wanted to support will have *meaningful* gifts to do their work.

Foundation "Pipeline" Strategy after Donor A's death



6 A qualified appraisal be required to verify the fair market value of $2 million.

7 Donor A will be able to use the $610,000 in tax savings on his final tax return.

8 The Foundation was one of the 5 charities that Donor A wish to support. The written direction is commonly referred to as a Deed of Gift.

9 Any Refundable Dividend Tax On Hand (RDTOH) in OpCo could be refunded by the taxable dividend paid to the Foundation.

Illustration Four: Private Foundation "Pipeline"

If the client has a redemption strategy in place for his or her preferred shares of their Holdco, the aforementioned foundation pipeline strategy works very well using a private foundation as the recipient charity. Everything as illustrated above is the exactly the same except the private foundation is controlled by Donor A's family. It is critically important that the shares be redeemed as soon as possible to avoid application of Excess Business Holdings (EBH) regime on the newly formed private foundation. This legislation requires the disposition of any class of shares owned by a private foundation and or persons not at arm's length with the private foundation when the combined holdings exceed 20 percent of the total share class. If the private foundation share class exceeds 2 percent and is less than 20 percent, additional reporting is required to Canada Revenue Agency. Excess Business Holdings does not apply when the private foundation owns 2 percent or less of any share class.

Why would one consider using a private foundation rather than a public one? As mentioned above, it has never been simpler to administer a private foundation than now. With the removal of the 80% spending requirement for tax receipted gifts, donors have the flexibility to decide how, how much, and when they will support the charities of their choice. Secondly, many public charities are unable to fund their activities the way the donor wishes. For example, the donor may not want to invest in a perpetual endowment, but would rather have the funds used over a period of time. This "diminishing fund" concept is not well received by most endowment-based charities. **Please note** that the Calgary Foundation has diminishing funds and other non-endowment gifts on its shelf now.

About the Author

DeWayne Osborn CGA, CFP is Lawton Partners' General Manager, Chief Compliance Officer and in-house expert on charitable and planned giving, DeWayne is one of Canada's leading authorities on planned giving. This makes him a valuable asset to the firm when it comes to advising clients who want to create meaningful financial goals that affect positive change in the lives of those around them.

Before joining the firm in 2000, DeWayne worked for the Health Sciences Centre Foundation, one of the many highlights of his experience serving in senior positions for non-profit organizations. This expertise, coupled with his professional knowledge as a Certified Financial Planner (CFP) and Certified General Accountant (CGA), has made DeWayne a highly sought-after public speaker and consultant on the financial complexities and philanthropic benefits that can be achieved by applying tax-effective strategies for gifting real property, cash, securities and life insurance products.

DeWayne was the 2011 recipient of the Canadian Association of Gift Planners' *Friend of Canadian Association of Gift Planning Award*, in recognition of his contributions to the charitable sector and professional advisor community.

If you have any questions with regard to the content of this article, or on planned giving in general, feel free to contact DeWayne Osborn directly at 1-888-944-1144 ext 256 or dosborn@lawtonpartners.ca.

If you would like more information on the services and Fund structures available through The Calgary Foundation, please contact Laily Pirbhai, Vice President Donor Engagement at lpirbhai@thecalgaryfoundation.org.

Advice for **Advisors**

APRIL 2013

Value of Donating Publicly Listed Flow-Through Limited Partnerships

by **Pierre Fournier,** Raymond James Financial Advisor

This article shares my experience and best practices of systematically managing, liquidating and donating FTLPs. By definition, flow-through shares (FTs) allow corporations in the oil and gas, mining and renewable energy sectors to renounce or "flow-through" tax expenses associated with eligible exploration, development and project start-up expenses to investors, who can deduct these expenses in calculating their own taxable income. FTs are treated as having a cost of zero for the purpose of calculating any gain or loss on their disposition. As a result, when an investor holding only flow-through shares sells them, the full amount of the proceeds received is recognized as a capital gain for tax purposes.

Budget 2006 introduced tax assistance for donations of publicly listed securities (including publicly listed flow-through shares) by eliminating capital gains tax on such donations to public charities and, in Budget 2007, extended this measure to all registered charities. Under Budget 2011,[10] the Federal Government legislated changes "*to allow the exemption from capital gains on donations of flow-through shares acquired on or after March 22, 2011 only to the extent that cumulative capital gains in respect of dispositions of shares of that class exceed the original cost of the flow-through shares.*" Flow-through shares bought prior to March 22, 2011 benefited from *"the deduction for the expenses flowed through from the corporation; applicable federal and provincial mineral exploration flow-through share tax credits; the Charitable Donations Tax Credit or Deduction in respect of the value of the shares; and relief from capital gains tax, including tax on the portion of the gain attributable to the zero cost of the shares."*

On average, about $600M in FTs are sold in Canada annually. At their peak, this number was as high as $1.2 B in some years, and as low as $200M in others. A contrarian approach to buy in leaner years has proven to be a more successful decision. About 75% of investors sell them at rollover, 23% keep them in a resource fund and less than 2% are donated. Of the 75% who sell them, 75% of them immediately buy a new FTLP. The 23% who keep them in hope of recovery are often disappointed in the final results.

The last 10 years of boom and bust cycles has necessitated that FTLPs be more actively managed to preserve capital. Some suggested actions: Prior to liquidity (usually 24 months before being able to sell), it may sometimes be prudent to contemplate hedging them, if possible, with options on a related commodity index. Selected funds are starting to offer this process. After an average 24 months holding period, they become liquid and may be sold, transferred to another less cyclical fund (money market or balanced/dividend fund) to protect capital without triggering a tax event, or donated to your favourite charity. Doing nothing is not a recommended path as these funds are often forgotten and lay dormant in accounts. There are many tens of millions $$ of such funds which may be considered for greater social and economic impact through proactive charitable gift planning.

Disclaimer: This is for information only and expresses the opinions of the author, not necessarily those of Raymond James Ltd. It is not meant to provide legal, taxation, account or account advice; as each situation is different, please seek advice based on your specific circumstances. Flow through shares may not be suitable for everyone due to the inherent risk of investing in resource stocks. Raymond James Ltd. Member-Canadian Investor Protection Fund.

10 http://www.budget.gc.ca/2011/plan/anx3a-eng.html#toc26

About the Author

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With over 25 years of hands-on multifaceted experience in business, engineering and financial planning, Pierre has had the opportunity to manage large multinationals in the US, Canada and Mexico. A career change in 2000 into the wealth management arena with Raymond James offered the opportunity to serve clients with independent views, reliable investment processes, risk management and a more holistic approach to wealth preservation and legacy planning. Pierre has been an active citizen and volunteer in the community having held many formal and informal appointments across public, private and non-for-profit organisations. His shared views on disseminating planning information and best practices to his clients and peers in the financial advisor field attracted him to work more closely with The Calgary Foundation where he has volunteered since 2006. Pierre enjoys travelling with both his adult daughters and can often be found year round hiking and skiing in the Rockies.