CLU™ INSTITUTE

COMMENT

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THE "ART FLIP" IS DEAD

A common tax/charitable planning technique was to donate property in kind to a charity. The value of the gift was the fair market value of the property at the time of the gift. A donation in kind also resulted in the realization of any accrued capital gain or loss on the property, since the taxpayer had disposed of it for tax purposes.

Tax shelter promoters took advantage of this strategy and created pre-packaged tax shelter arrangements. These arrangements generally involved the purchase of property in bulk, subsequently followed by the donation of individual pieces of property to a charity. While the cost of each property, when bought in bulk, was very low, the value of each property on an individual basis (which was used to determine the amount of the gift) was high. In some cases, the taxpayer saved more in taxes than the combined cost of the property and the tax liability resulting from the capital gain on the disposition of the property. Some of the types of property used by various tax promoters included art prints, comic books, computer software, prescription drugs, and wine. Many of the original arrangements involved the donation of artwork, and for this reason, the name "art flips" gained common usage.

On December 5, 2003, John Manley, deputy prime minister and minister of finance, released draft legislation to deal with this perceived abuse of the charitable donation system. The news release that accompanied the draft legislation indicated that the intention of the rules was to eliminate "buy low, donate high" arrangements.

To ensure that property is not purchased at a low cost with the intention of donating it at a much higher value, the proposed legislation will deem the fair market value for a gift of property to be the lesser of the property's fair market value and its cost or adjusted cost base to the taxpayer. This new deeming rule effectively eliminates the purchase of property with the intention of immediately "flipping" it as a donation in kind.

There are a number of exceptions to the above deeming rule. First, the rule does not apply to gifts of inventory, publicly traded securities, certified cultural property, ecological gifts, or real estate situated in Canada. Second, where the property was not acquired under a "gifting arrangement" (as defined under the tax shelter rules of the Income Tax Act), the rule will not apply to:

- gifts arising as a consequence of death, or
- gifts where the taxpayer acquired the property more than three years prior to the time of the gift and the property was not purchased with the intention of eventually giving it to a charity.

This change was effective as of 6 p.m. EST on Friday, December 5, 2003.

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While the new rules are well intentioned, they may limit legitimate opportunities for charitable gift planning. In particular, a number of issues arise with respect to shares of private companies. For instance, a shareholder may have owned shares of a private company for more than three years, but may have implemented an estate freeze within the last three years. In this case, the new preferred shares issued in the freeze would not meet the three-year test. Even where the three-year test is met, the taxpayer could be deemed to have donated the shares at their ACB if the taxpayer had planned to donate them at the time of the reorganization.

In addition to the new "buy low, sell high" rules, the draft legislation in the December 5 press release integrates, with some revisions, the charitable gifting changes that were originally announced on December 20, 2002. These rules provide that the amount of a donation must be reduced by any advantage that the donor receives as a result of making the donation (and an advantage may include limited-recourse debt). If the advantage exceeds 80 per cent of the gift's total value, the entire donation may be disqualified unless the donor can establish that there was an intention to make a gift. These are the "split receipting rules" affecting charitable gift annuities that were discussed in the January/February 2004 issue of Comment.

Beyond the taxpayer being denied the anticipated tax benefit, under the new rules charities may also face harsher penalties for issuing receipts inappropriately. Accordingly, it has become even more important to consult a knowledgeable financial planning professional before entering into a charitable gift planning arrangement.

I/R 1600.05, 7501.00

POLITICAL CONTRIBUTIONS

Individuals and companies make political contributions for many reasons. Some give because they want to support the candidate or party, while others may believe that the gift could provide goodwill and possible future benefits.

While donations to a political party are not tax-deductible, income tax relief is offered to individuals and companies in the form of a non-refundable tax credit. Generally, a federal tax credit can be claimed for donations to federal political organizations, while a provincial or territorial credit can be claimed for donations to provincial and territorial parties.

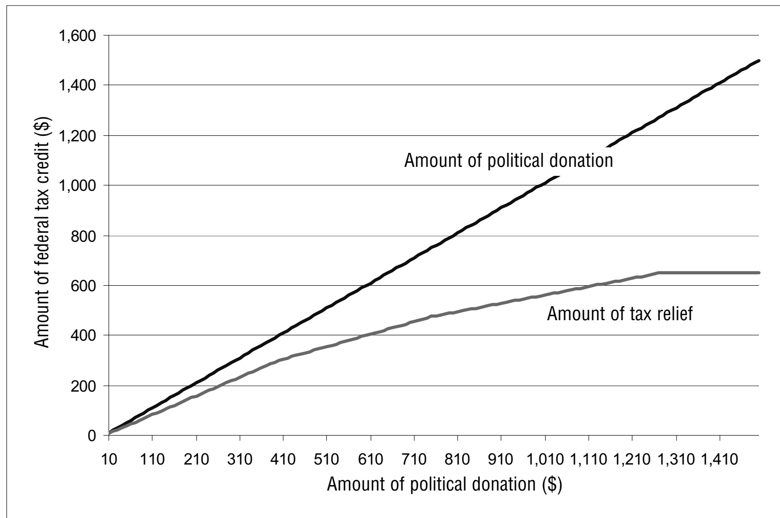
The federal tax credit will be available for contributions to a registered party, a provincial division of a registered party, a registered association, or a candidate (as those terms are defined in the Canada Elections Act). For federal contributions made after 2003, the following tax credit limits will apply:

- 75 per cent for donations less than or equal to $400;
- $300 plus 50 per cent of amounts between $400 and $750;
- $475 plus 33 1/3 per cent of amounts over $750, to a maximum credit of $650.

The rules impose an overall maximum federal credit of $650, which limits tax relief to donation amounts of up to $1,275. Donations in excess of $1,275 will not generate any tax credit. The following graph illustrates this cap in the total amount of tax relief as well as the fact that, as the amount donated increases, the amount of additional relief decreases.

Note that the first portion of the donation generates the highest level of tax relief. If an individual who is married or has a common-law partner donates an amount greater than $1,275, consideration should be given to making the donation in the joint names of the individuals. Similarly, if a couple shares the claim for political gifts, they should share the claim equally rather than having one claim $1,275 and the other the excess.

In addition to using the tax system to limit political donations, Elections Canada recently introduced a new set of rules limiting overall contributions. These rules are effective January 1, 2004. Individuals cannot give more than $5,000 per year to each political party or leadership contestant.



Corporations and trade unions cannot give more than $1,000 per year in total to the candidates of each political party. Corporations and trade unions cannot make gifts to political parties or to leadership contestants.

I/R 7401.00

GOVERNMENT PENSION PLANS: BENEFITS AND CONTRIBUTIONS FOR 2004

Contributions and benefits under government pension plans are adjusted periodically to reflect increases in the consumer price index or the average Canadian wage. The new amounts, commencing January 1, 2004, 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)	$814.17	$814.17	
Disability pension	$992.80	$992.77	
Disabled contributor's child benefit (each child)	*$192.68	*$61.18	
Survivor's*** pension			
• under age 55	**$454.42	**$687.45	
• age 55 to 64	$454.42	$704.90	
• age 65 or over	$488.50	$488.50	
Surviving child's benefit (each child)	*$192.68	*$61.18	
Death benefit (lump sum)	$2,500.00	$2,500.00	
Combined benefits			
• survivor's*** pension and disability (under age 65)	$992.80	n/a	
• survivor's*** pension and retirement (age 65 and over)	$814.17	$814.17	
Annual CPP/QPP contribution			
Self-employed (9.9%)	$3,663.00	$3,663.00	
Employee (matched by employer) (4.95%)	$1,831.50	$1,831.50	

	CPP	QPP	OAS
Old Age Security (OAS)			
January to March 2004			$462.47
Guaranteed Income Supplement (GIS)			
January to March 2004			
• spouse/common-law partner receives OAS or Allowance			$358.01
• single person (or spouse/common-law partner receives neither OAS nor Allowance)			$549.63
Allowance			
January to March 2004			
• age 60 to 64, and spouse/common-law partner receives OAS and GIS			$820.48
• age 60 to 64, survivor's*** Allowance			$905.83

Notes:

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

I/R 3201.01 and 3201.03

Contributors to this issue of Comment:

James W. Kraft, CFP, CLU, CH.F.C., CA, MTAX, TEP
Deborah Kraft, CFP, CLU, CH.F.C., TEP

Published by:

CLU Institute
350 Bloor Street East, 2nd Floor,
Toronto, Ontario M4W 3W8
P: (416) 444-5251 or 1-800-563-5822
F: (416) 444-8031
www.cluinstitute.ca • info@cluinstitute.ca

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