

# REFERENCE GUIDE

**WEALTH PLANNING** GROUP

## **PRIVATE AND PUBLIC FOUNDATIONS**

## Private and public foundations

Charitable foundations, which can be either private or public, can be effective vehicles for charitable giving.

This Reference Guide provides an overview of some of the important information that should be considered regarding establishing and donating through a private foundation, and donating through a public foundation.

### GENERAL

Both public and private foundations must be registered as charities under the federal Income Tax Act. Registration exempts the foundation from paying income tax and also allows the foundation to issue official tax receipts to donors, which the donors can then use to reduce their own taxes through the charitable donation tax credit (or deduction), as discussed below.

The primary difference between a private and public foundation is that a private foundation receives most of its funding from, and/or is controlled by, one person or a group of persons at non-arm's length with each other, while a public foundation has a broader source of control and funding.

If an individual and his or her family intend to make significant charitable donations into the future, they may wish to do so through a private foundation. The individual and family members would then make donations to the private foundation during their lives and/or through their wills, rather than directly to other charities. The private foundation would then use the donation funds to operate its own charitable programs and/or disburse the funds to other registered charities as and when the directors or trustees determine (subject to meeting the annual disbursement quota, discussed below).

As an alternative to establishing a private foundation, an individual who intends to make a significant charitable contribution may consider making a "designated gift" to a public foundation, if permitted by the public foundation. Typically, with a designated gift, the public foundation would agree to accept a gift subject to the condition that the donated funds are kept in a separate sub-fund, with the income from the sub-fund to be used by the public foundation to operate its own charitable programs or distributed to a specific organization for a specific purpose or for a specified area of interest.

## PRIVATE FOUNDATIONS

### Benefits of Creating a Private Foundation

There are many benefits of establishing a private foundation, both philanthropic and tax-related.

#### *Philanthropic Benefits*

##### Larger Gifts

Since a private foundation is a tax-exempt entity, the income earned on amounts donated to it will accumulate free from tax. This allows for a greater amount to be available for charitable purposes. In addition, as a result of the tax savings available to donors through the use of the charitable donation tax credit or deduction (discussed below), the use of a private foundation can often allow an individual and his or her family to make larger charitable gifts than they may have thought possible.

##### Control Over Timing

The use of a private foundation allows donations to be made at the convenience of the donor (for tax or other reasons) rather than at the convenience of the charity.

##### Unified Family Giving

A private foundation allows all family gifts to be made through one identifiable entity. Depending on the family's intentions, this entity can be used either to publicize gifts that the family has made or to provide anonymity for the donors if that is what is preferred.

##### Living Legacy

A private foundation can provide the individual with some degree of certainty that his or her charitable objectives will continue to be achieved on a long-term basis and will be carried forward to future generations. Members of the family can be involved in the foundation at various levels, for example as donors, directors or trustees, or even employees of the foundation.

#### *Tax Savings*

##### Charitable Donation Tax Credit or Deduction

As a registered charity, a private foundation will issue donation receipts for amounts donated to it. These receipts entitle the donors to claim either a tax credit (in the case of individual donors) or a tax deduction (in the case of corporate donors).

In general, during lifetime, a donor can claim a charitable donation tax credit of up to 75% of the donor's net income in the year of the donation. Any unused portion of the receipt can be carried forward for up to five years. There are also special rules that apply on a donor's death that permit a donation receipt to be used to offset 100% of the donor's income in the year of death, with any excess allowed to be carried back to reduce taxes in the year immediately preceding the

year of the donor's death. As well, gifts of certified cultural property and qualified ecological property entitle the donor to a 100% limit.

Further information regarding the charitable donation tax credit can be found in our Reference Guide on Charitable Giving.

### Gifts of Publicly Traded Securities and Ecological Gifts

When a donor donates publicly traded securities, or makes an ecological gift, to a foundation, there is a disposition for income tax purposes. Normally, such a disposition would be subject to capital gains tax to the extent the fair market value of the donated property exceeds the donor's adjusted cost base in the property. However, there is a special tax rule that deems the taxable capital gain on the disposition of such property to be zero when it is donated to a registered charity, which includes private foundations. As a result, the tax benefits of donating are enhanced for these types of gifts.

Further information regarding the zero taxable capital gains inclusion for donations of publicly traded securities can be found in our Reference Guide on Charitable Giving.

### Property That Should Not Be Donated

The Income Tax Act includes some anti-avoidance measures to prevent donors from obtaining the tax benefits associated with making a charitable donation while retaining effective control or use over the donated property.

For example, if an individual donates shares (or a right to acquire such shares) or debt issued by a private corporation controlled by the individual, the individual will not be allowed to claim a charitable donation tax credit for the donation, as these are considered to be non-qualifying securities. However, if such a gift is made, the tax credit may be claimed if (and when) the foundation disposes of the non-qualifying security within 60 months of the gift in exchange for consideration that is not a non-qualifying security, or if the security ceases to be non-qualifying.

### **Establishing a Private Foundation**

If you are considering establishing a private foundation, you should be aware of what is involved in creating and operating a private foundation.

#### *Corporation or Trust?*

A private foundation to be established by an individual can be set up as a corporation or a trust. There are some key differences between these two types of entities. The choice of which entity to use will typically depend on administrative and operational requirements and on the individual's personal preference.

### Corporation

A corporation must be incorporated under the relevant provincial or federal legislation that governs corporations.

The corporation can be established without share capital and would have a board of directors as well as members. The members could (but are not required to) be a defined group of people, such as individuals related to the person creating the foundation by blood, adoption, marriage or common-law relationship. The main responsibility of the members would be to vote for the board of directors from year to year, as well as on other fundamental corporate changes.

As a result of certain Income Tax Act requirements regarding the directors of a charity, we recommend that there be a minimum of three directors for a charity (and the relevant provincial or federal legislation governing the charity may require a minimum of three directors in certain cases). The directors would be charged with managing the charitable activities of the corporation. In turn, the directors could appoint or hire a manager or administrator and delegate many of the day-to-day activities to that person. As indicated above, the manager or administrator could be a family member if desired. Subject to various statutory exceptions regarding unpaid taxes, source deductions and wages, the directors would generally be protected from personal liability in respect of actions taken by the corporation.

### Trusts

A trust is an entity that is governed by statute, the common law and the agreement under which it is created. To establish a charitable trust, an individual (referred to as the “settlor”) would generally transfer an initial sum of money to trustees, who would hold the money in accordance with the terms of a trust agreement. The trust agreement would set out, among other things, the powers and duties of the trustees, as well as the charitable purposes of the trust.

In order to meet certain requirements under the Income Tax Act regarding the trustees, we recommend that there be a minimum of three trustees for a charitable trust. The settlor (that is, the individual who made the initial contribution) could be one of the trustees, but for tax reasons should not have control over the decisions of the trustees.

### Annual Requirements

There are different annual reporting and filing requirements, depending on whether a foundation is established as a corporation or as a trust.

For example, a corporation must file annual returns with the applicable incorporating authority (whether federal or provincial) and must hold annual meetings or pass annual resolutions. There are no similar obligations for a trust.

However, both a corporation and a trust have to file information returns with Canada Revenue Agency (the “CRA”) every year.

### *Registration*

As mentioned above, a private foundation, whether created as a trust or a corporation, must be registered as a charity with the CRA.

In order to register the foundation, an application must be submitted to the CRA in the form required. Certain documents and information must be submitted along with or as part of the application form. This includes the governing documents of the foundation, a list of its directors or trustees, an estimated budget for the first fiscal year of the foundation and information about the activities of the foundation showing how the foundation intends to achieve its goals. An individual should consult with his or her professional advisors for assistance in preparing the application and the accompanying material.

For straightforward applications (such as those for foundations whose objects are clearly charitable), the CRA will usually require at least a few months to process the application. More complex applications (such as those for foundations seeking registration with novel charitable purposes) may require processing time of up to one year.

### **Operational and Administrative Requirements For A Private Foundation**

The following are some important operational and administrative requirements involved in establishing and operating a private foundation.

#### *Charitable Purposes*

As a registered charity, a private foundation must be organized and operated exclusively for charitable purposes. The common law defines a charitable purpose to mean:

the relief of poverty

the advancement of education

the advancement of religion

certain other purposes beneficial to the community as a whole.

The governing documents of a charitable foundation (either the articles of incorporation and by-laws in the case of a corporation or the trust agreement in the case of a trust) must state the objects or goals of the foundation, which, in turn, must fall within the above categories.

Note that a foundation has the ability to either carry on charitable activities directly itself or provide funds to “qualified donees” (essentially, other registered charities), or perform a mix of both.

#### *No Personal Benefits*

Other than reasonable salaries, no benefit from the foundation may be available or provided to its members, settlors or trustees.

### *No Business*

A private foundation cannot carry on any business.

### *No Debt*

A charitable foundation, whether private or public, is not permitted to incur any debt, other than debts incurred for current operating expenses, debts incurred in the course of administering charitable activities or debts incurred in connection with the purchase and sale of investments.

### *Public Disclosure*

Certain information relating to registered charities is required to be made available to the public, including most of the information required to be provided by the charity in its application for registration.

### *Winding-Up*

When and how a foundation should be wound up can be left to the discretion of the directors or trustees. The governing documents of the foundation must provide that on a winding up, any remaining funds will be distributed to other registered charities.

### *Disbursement Quota - Generally*

Like all registered charities, a charitable foundation must comply with the annual disbursement quota rules set out in the Income Tax Act in order to retain its registered charity status. The disbursement quota rules set a minimum amount that a foundation must spend on its own charitable activities and/or gifts to other “qualified donees” each year to ensure that it dedicates an appropriate portion of its resources to charitable purposes.

The disbursement quota is calculated based on the value of a foundation’s assets that is not used for charitable activities or administration (i.e., generally, the foundation’s investment assets, which include any real estate or investments not used directly in charitable activities or administration). If the average value of a foundation’s investments over the 24 months preceding the beginning of the foundation’s current fiscal period exceeds \$25,000, the foundation must disburse at least 3.5% of the value of its investment assets to meet its disbursement quota.

The annual disbursement quota can be met by the foundation spending funds directly on its own charitable activities and/or transferring funds to other registered charities.

Because the disbursement quota rules can be complex, we recommend that professional advisors be retained to assist with compliance.

### *Other Administrative Requirements*

As noted earlier, in order to maintain its status as a charity, a foundation must file an annual information return with the CRA. There are also rules regarding the types of investments a private foundation can (and cannot) make and penalties for non-qualified investments.

Care must be taken in the operation and administration of the foundation to ensure that its registered charity status is not put in jeopardy.

### **Costs of A Private Foundation**

There are costs involved in establishing a private foundation and in its ongoing maintenance and administration.

#### *Costs of Establishing a Private Foundation*

There will generally be legal and accounting costs related to the creation, organization and registration of a private foundation. Legal costs may be about \$5,000 - \$10,000 (or more in complicated cases). Accounting costs will typically be less. In the event that a tax-planned initial donation is intended and any special deeds of gift or transfer documents are required, there would likely be additional legal and accounting costs.

#### *Costs of Maintaining a Private Foundation*

The accounting costs relating to the ongoing maintenance of a private foundation, which include the filing of annual information returns required under the Income Tax Act, may be in the range of \$2,000 to \$4,000 each year. Legal costs for ongoing maintenance of a private foundation, including the filing of corporate annual returns, may be in a slightly lower range absent any significant compliance issues or CRA audits.

#### *Costs of Administering a Private Foundation*

If desired, a family member may administer the grants or donations made by the foundation, either on a volunteer basis or for a reasonable salary. Alternatively, a professional may be hired to do so.

These costs should not deter an individual from considering a private foundation if all other circumstances suggest that it would be beneficial.



## PUBLIC FOUNDATIONS

As indicated above, a designated gift to a public foundation may be considered as an alternative to creating a private foundation.

### Benefits of Designated Gifts to Public Foundations

There are many benefits of making designated gifts to public foundations, both philanthropic and tax-related.

#### *Philanthropic Benefits*

##### Larger Gifts

As discussed above, public foundations are registered charities, and, as such, are tax-exempt. Therefore, the income earned on amounts donated to a public foundation will accumulate free from tax. This allows for a greater amount to be available for charitable purposes.

##### Control

The use of a designated gift to a public foundation allows the donor to have some control over how the gift is used since, at the time the gift is made, the donor can designate how the gift and resulting income are to be spent or disbursed. However, after the gift is made, control rests with the public foundation. The donor does not have the ability to enforce the terms of the gift and has little or no recourse should the donor disagree with how the amount donated or the incomes earned are being used. Accordingly, the donor must trust that the public foundation will respect his or her wishes.

If greater control over the gift is desired, a public foundation may sometimes permit a donor to establish a donor-advised fund with the gift. With this type of fund, the donor and/or the donor's representatives can provide recommendations each year regarding distributions from the fund holding the gift and the income earned on it. This opportunity would likely only be available if there is a specified minimum amount in the fund.

Despite reduced control, one benefit of designated gifts to public foundations is that they are easier and less costly to implement and administer than the creation of a private foundation. The deed of gift required to make a designated gift to a public foundation is also significantly less complicated and less costly than establishing a private foundation. In addition, the administration and compliance burden to fulfill the on-going reporting and operational requirements of a registered charity are borne by the public foundation receiving the designated gift, instead of by the person who would otherwise have established a private foundation.

##### Privacy

Designated gifts to a public foundation can provide anonymity to the same extent that private foundations can. If, however, public awareness or recognition is desired (for example, if the gift

is donated in memory of a person the donor wishes to publicly recognize) the public foundation may agree to operate a sub-fund under the name that the donor wishes to be used.

### Living Legacy

As with a private foundation, designated gifts can provide an individual with an opportunity to make a lasting gift for charitable purposes. However, the degree of certainty will be based on the extent to which the donor trusts the public foundation to respect the donor's wishes. In some cases, this may not be as effective as establishing a private foundation to carry out the donor's wishes.

### *Tax Savings*

#### Immediate Donation Tax Credit or Deduction

As with a private foundation, the tax savings that can be achieved through the use of designated gifts to public foundations are provided through the charitable donation tax credit or deduction.

Designated gifts to public foundations qualify for the same donation tax credit or deduction and zero taxable capital gains inclusion treatment for gifts of publicly listed securities and ecological gifts as described above in our discussion on private foundations.

#### Property That Should Not Be Donated

A public foundation may not be able to accept a designated gift if the gift would result in the public foundation being offside restrictions set out in the Income Tax Act regarding the maximum amount of capital that can be contributed by one person or group of persons not dealing at arm's length with the foundation.

Also, the limitations described above on the availability of tax credits related to gifts of shares and debt obligations may apply. However, an exemption from these limitations may be available for gifts of shares to a public foundation where the donor deals at arm's length with the foundation and with each director, trustee, officer, and like official of the foundation.

### **Requirements of Designated Gifts**

If, instead of creating a private foundation, a designated gift is to be made to a public foundation, the gift must meet the following criteria in order for the foundation to hold the gift as a sub-fund:

The gift must be evidenced in writing.

The donor must execute the document evidencing the gift. This document may sometimes be referred to as a "deed of gift".

The document must clearly identify the foundation receiving the gift (the "donee"), including its official name and registration number.

The document must also set out:

- the amount of the gift
- the date of the gift
- the name and address of the donor
- the serial number of the official receipt issued to the donor for the gift.

The deed of gift should also specify what, if any, restrictions the donor may wish to have applied with respect to the use of the gift.

The deed of gift document should be prepared in consultation with professional advisors and the public foundation.

## CONCLUSION

A charitable foundation can be a very effective vehicle for fulfilling an individual's charitable objectives.

Given the numerous considerations that should be taken into account when deciding whether to establish and operate a private foundation or gift to an existing public foundation, it is advisable to consult with professional legal and accounting advisors who are knowledgeable and experienced in this area.



For more information, we encourage you to speak to your advisor or visit us at [assante.com](https://www.assante.com)

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