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TAX MATTERS

How charitable remainder trusts let you provide for heirs while doing some good

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If you haven't updated your will in a while, the summer months are a great time to do this. You may even want to have a little fun in the process. I've mentioned before the story of Charles Vance Millar, the Toronto lawyer who died in 1926 and bequeathed big dollars to any Toronto woman who could give birth to the most children in the decade following his death. The contest became known as the "Stork Derby" (four winners tied with nine children each, the mothers receiving about $125,000 apiece). Then there was Gene Roddenberry, creator of Star Trek, who came up with the notable quote "to boldly go where no man has gone before." His will provided instructions to scatter his ashes in space by way of a satellite orbiting Earth.

On the other hand, if you intend to provide an income to a loved one after you're gone and want to help your favourite charity at the same time, consider the use of a Charitable Remainder Trust (CRT) in your will. Let me explain.

HOW IT WORKS

Suppose you have a child, or other person, who will benefit from some financial support after you're gone. This could be in the form of a supplemental income that you could provide. Suppose also that you have a desire to help your favourite charity after you pass away.

You could accomplish both objectives by transferring cash or certain investments to a trust upon your death. You'll still face the tax on a deemed disposition of those assets on death (the transfer to the trust won't allow you to escape this, unless it's a trust for your spouse and meets certain conditions). The terms of the trust would be spelled out in your will. You could specify that your heir would receive all the income of the trust while he or she is alive, and your favourite charity will receive the capital, or assets, of the trust upon the death of your heir. In technical language, your heir is said to have a "life interest" in the trust, and the charity is said to have a "remainder interest" (or "residual interest") – hence the name, Charitable Remainder Trust.

The good news is that, with proper wording in your will, you'll be entitled to a donation tax credit on your final tax return even though the charity won't receive the money for, perhaps, many years after your death. The case O'Brien Estate v. MNR (91 DTC 1349) established that a donation tax credit will be available for the value of the remainder interest that the charity will one day receive, if set up properly.

The terms of the CRT in your will must not allow your heir, or anyone else, to encroach upon the capital (that is, access the assets) of the trust, otherwise a donation credit won't be available. Your heir can only access the income of the trust. This makes sense because it would be impossible to calculate the value of the remainder interest to be received by the charity if your heir could dip into the capital for their own use during their lifetime.

THE NUANCES

You won't be entitled to a donation credit for the full value of what's placed in the CRT upon your death. The value of the donation credit is determined by an actuarial calculation based on the age and health of your heir. Basically, the actuary will arrive at a value for the remainder interest that's eventually going to the charity, taking into account that it won't end up in the hands of the charity for some time. It's that value that the charity will use to issue a donation receipt and can be claimed on your final tax return.

A CRT is a trust like any other trust; it's not a charitable organization. So, there would be tax filings each year for the trust, and any income in the CRT would be taxable (in the hands of your heir if it's payable to them).

Another option: You can set up a CRT to take effect during your lifetime instead. If you were to transfer existing assets into a CRT in this manner, those assets would be deemed sold at fair market value upon that transfer (unless you set up the trust as an alter ego trust – but that's a topic for another day), you could draw an income from the CRT during your lifetime and receive a donation credit today. Be sure to get tax advice before setting up a CRT and check out the taxman's Interpretation Bulletin IT-226R – as dry as that reading may be.

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