O'SULLIVAN
ESTATE LAWYERS

April 2026

Advisory

Charitable Giving

People support charities for a variety of reasons. Some donate to a hospital or health charity that has provided assistance to a close relative or friend. Or perhaps there are strong ties to a particular religious or cultural organization, or to a favourite school or university. Where an individual has made charitable gifts during his or her life, he or she may have a strong desire to incorporate gifts to charity in his or her estate plan. Individuals who have not been inclined to make charitable gifts during their lifetime for a variety of reasons may wish to make charitable gifts on their death. The goal of this summary is to provide you with general information on charitable giving as part of an estate plan, including relevant tax and non-tax considerations.

PRELIMINARY CONSIDERATIONS

Identify your Charitable Objectives

When contemplating charitable giving as part of an estate plan, it is important to identify your philanthropic objectives. Specifically, is there a particular cause or purpose that you wish to support? Do you have one or more favourite charities in mind? Do you wish to make gifts from time to time (such as gifts of cash) or do you wish to establish a lasting gift that bears your name (such as an endowment fund)? Do you want to make gifts now or at the time of your death or both? All of these factors must be considered.

Identify your Financial and Personal Circumstances

It is also important to consider your charitable objectives in the context of both your financial resources and your personal obligations. For example, do you have dependants or obligations to your spouse, and if so, how should their interests be considered in relation to your charitable intent?

Ontario law recognizes that individuals are generally free to benefit whoever they choose—individuals or charities—during life or under the terms of a will. However, that freedom is tempered where a person may have obligations to provide for dependants such as children, a common law spouse, and/or a surviving married spouse. Ontario law also confers the right

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to make a claim for equalization of property to a surviving married spouse, in lieu of receiving benefits under the will of a deceased spouse, as well as insurance proceeds and lump sum payments under pension and similar plans.

Tax Considerations

The annual general donation claim limit for an individual or a corporation is 75% of net income. Donations in excess of the annual limit can be carried forward and claimed in the five succeeding years. It may be advantageous to consider making a charitable donation in annual instalments during your lifetime in order to benefit from claiming the donation tax credit over six years if appropriate.

With regard to the tax treatment of a gift by will, the annual general donation claim limit increases from 75% to 100% of net income in the year of death and the year immediately preceding death if the deceased's estate is considered a "graduated rate estate" ("GRE") at the time the gift is made to the charity. A GRE means:

1. an estate that arose as a consequence of an individual's death;
2. no more than 36 months have passed since the date of death;
3. the estate is considered a testamentary trust for tax purposes;
4. the estate designates itself as a GRE;
5. no other estate (related to the deceased) designates itself as a GRE; and
6. the deceased's social insurance number is provided in the estate's tax return.

A donor can deduct 80% of the charitable tax credit to reduce any Alternative Minimum Tax ("AMT") payable. The AMT system imposes a minimum level of tax on individuals who claim certain tax deductions, exemptions, or credits to reduce their taxes to very low levels.

Donation tax credits with respect to charitable gifts made by will can be used in the taxation year of the estate in which the gift is made to the charity, any prior taxation year of the estate, the year of death, and the year immediately preceding death as long as the estate is a GRE at the time the gift is made to the charity. In addition, the usual rule for five-year carryforward will apply.

As noted above, an estate is a GRE only for 36 months after death. As a consequence, it is important to ensure that all gifts made by will are made to the charity no more than 60 months from the date of death. Where a gift is made between 36 and 60 months after death,

a former GRE will only be able to use the donation tax credit in the year the donation is made or an earlier taxation year of the estate if the estate is a GRE in that preceding year, or the last two taxation years of the deceased individual.

If the gift is made to a charity by an estate that is not a GRE, the estate can only apply the donation tax credit against its income earned in the year the gift is made or with certain exceptions any of the five succeeding years. If the estate has little or no income in such years, the donation tax credit would be of little or no benefit in such circumstances.

Identify Assets to be Gifted to Charity

Another consideration is which assets to donate to charity. A person can gift cash, shares, employee stock options, mutual funds, bonds, artwork, real property (including ecologically sensitive land), proceeds of life insurance, Canadian cultural property, or other property. Where a person has a charitable intention but has no funds with which to make a gift, life insurance is one means by which to provide the necessary funds to make a charitable gift at death.

Gifts of certain assets, such as shares listed on a prescribed stock exchange, mutual fund shares and units, segregated fund units, ecological gifts, and Canadian cultural property are given favourable tax treatment. For example, when a person makes a gift to a qualified charity of shares in specified publicly traded companies that have appreciated in value, the donor receives a tax receipt for the fair market value of the shares at the time of transfer, and can take advantage of the reduced capital gains inclusion rate, which is eliminated for income tax purposes and partially reduced for AMT purposes. This is also available where there is a gift of such property to a private foundation, putting private foundations on equal footing with public or community foundations. In order for an estate to benefit from the above favourable tax treatment, it is necessary for the gift made by will to be made by an estate that qualifies as a GRE.

Other assets, such as life insurance, allow a person some flexibility as to timing of the gift and receipt of a charitable donation tax credit, which can be used to reduce income tax.

One downside of donating specific property on death is that it may be necessary to obtain additional valuations. For instance, if real estate is donated, it will often be necessary to determine its value at the time of death (under the *Income Tax Act,* a person is deemed to have sold all of his or her property on death and therefore it is necessary to determine the fair market value of such property on death) and also at the time of its transfer to the charity in order to determine the donation amount. In order to avoid having a second valuation done at the time the property is transferred to the charity, which can be expensive

depending on the nature of the property, in certain cases the preferred option may be to instead donate money.

METHODS FOR CHARITABLE GIVING

Gifts During Your Life and by Will

You can choose to make charitable gifts during your lifetime, such as gifts of cash, shares or other property. When making a significant gift to charity, it is generally advisable to liaise with the charity, particularly if you want to stipulate terms for the use of your gift.

Many individuals choose to make charitable gifts under their wills. This can be achieved in a simple way by naming a charity as a beneficiary of cash, shares, or other property under your will. For example, one may wish to make a bequest to a charity of a particular sum for general purposes (i.e., "the sum of $10,000 to ABC Hospital" or "the sum of $10,000 to XYZ University") or for a specific purpose (i.e., "the sum of $10,000 to ABC Hospital for the purpose of advancing neonatal research" or "the sum of $10,000 to XYZ University to be used to provide bursaries to be awarded in my name to students in the Faculty of Engineering at XYZ University who have demonstrated academic excellence as determined by the applicable governing body of the University").

The donor must determine whether he or she wishes to leave a gift of cash, donate specific property, or use another means for gifting (for example, designating a charity as the beneficiary of proceeds of a life insurance policy or RRSP). It is advisable to provide under the terms of a will that payment of the gift can be made in cash or in-kind to allow for a donation of shares in certain publicly traded companies and other qualifying gifts to take advantage of the reduced capital gains inclusion rate. A gift to charity by will can be effected immediately following the death of an individual, or a provision can be made for a "charitable remainder trust" (discussed below), whereby another beneficiary can enjoy the income on the gifted property for a stated period such as his or her lifetime, following which the property remaining will be transferred to charity.

It is important to confirm the proper name of the charitable organization and its status as a registered charity. In case the charity later changes its name or winds up, provision can be made for an alternative gift to another charity, or discretion can be given to the executor named in the will to make a gift to another charity that most closely resembles the charity originally named, and is consistent with the spirit and intention of the gift.

It is also possible for a person to delegate to his or her executor the authority to choose the charities that are to benefit. Direction or guidance to the executor as to which charity or charities should benefit from the gift and the parameters of the gift (such as the amount and

special purposes and terms) can be provided either in the will or in a non-binding Letter of Wishes. The current position of Canada Revenue Agency ("CRA") is to allow a donation tax credit in the deceased's terminal tax return not only where specific qualified charities under the *Income Tax Act* (Canada) are named in the will, but also where no specific qualified charities are named in the will and the estate trustee has discretion to select one or more qualified charities to benefit.

If you are making a charitable gift by way of will, you may wish to consider notifying the charity of your intended gift following the signing of your will. Some charities have programs or special events to acknowledge a donor during his or her lifetime. On the other hand, you may wish to remain anonymous to ensure privacy.

It is important to note that any gift you make to charity by way of a will is revocable until your death so long as you are able to change your will. Also, if proceeds of a life insurance policy or a registered plan (i.e., RRSP or RRIF) are donated to a charity by a designation in your will, the designation is revocable, unless it specifically states it is irrevocable. Donations may also be made by way of a separate written designation under the policy or plan. If there is an inconsistency between the designation in a will and a designation by separate written designation under the policy or plan, the designation that is most recent in time will govern.

RRSPs, RRIFs, and Life Insurance

In general, the value of an RRSP or RRIF asset is included in your taxable income at death unless the proceeds are transferred to a plan for your surviving spouse or for a financially dependent child or grandchild. If the proceeds of your RRSPs or RRIFs are designated to a charity, the charity will receive the proceeds, and your estate will claim a donation tax credit.

If you donate a life insurance policy to charity, you may be eligible for a donation tax credit, provided that the policy is absolutely assigned to the charity so that it is the owner and the beneficiary of the policy at the time of the gift. Disposition of a policy can give rise to an income inclusion and resulting tax, and this must be factored in. The amount eligible for the donation tax credit is the net cash surrender value of the policy less any policy loans, plus any accumulated dividends and interest at the time of the transfer. Any further premium payments would also qualify for a credit.

Alternatively, instead of donating a policy, you may wish to donate the proceeds of a life insurance policy to a charity upon your death by designating the charity as a beneficiary either under your will or by separate written designation under the policy or plan. Upon your death, the charity would receive the insurance proceeds tax-free and your estate would be eligible to claim a donation tax credit.

The *Income Tax Act* allows for a donation tax credit to apply to donations of insurance, RRSP, and RRIF proceeds that are made as a result of direct beneficiary designations to a charity, whether by will or by separate written designation under the policy or plan. In addition, by designating a beneficiary of your insurance, RRSP, or RRIF, you will also minimize your estate's exposure to Ontario's Estate Administration Tax ("probate tax"), as assets transferred to a designated beneficiary, including a charity, pass outside of the estate and are not subject to probate tax.

Charitable Remainder Trusts

A charitable remainder trust may be an attractive option to an individual who wishes to make a substantial gift in his or her lifetime but wants to retain the income from the property donated. A trust is established by the donor irrevocably transferring property, such as cash or securities, to one or more trustees. The terms of the trust would be set out in a trust agreement. The donor would receive income from the property during a stated period such as his or her lifetime (which would be included in the donor's annual income for tax purposes) and would appoint one or more charities as capital beneficiaries entitled to share the property remaining in the trust on the death of the donor. The donor would be entitled to an immediate charitable tax receipt on the transfer of property to the trust. The value of the gift is determined by discounting the current value of the property using the life expectancy of the donor and a current interest factor. A capital gain may result if the value of the gift exceeds the cost base of the property. Because trust assets are not held by the donor at the time of his or her death, the trust assets pass outside of the estate and are not subject to probate tax.

A charitable remainder trust may also be established under a will, although this may not be a favourable option as a result of the GRE regime (which came into effect in 2016). CRA's administrative position is that where a will establishes a trust and gifts the remainder interest in the trust to a charity, the gift will not qualify as a gift by a GRE. The gift will not have the favourable tax treatment, including being able to claim the donation tax credit in the year of death and the preceding year. For example, income on assets may be used to provide for the needs of a surviving spouse or other beneficiary for his or her lifetime, and upon his or her death, the remaining trust assets would pass to a charity or charities. The surviving spouse or other beneficiary would pay tax on the income received from the trust. If a charity is the irrevocable beneficiary of the trust and provided there is no power to use capital for the income beneficiary, the charity will issue a charitable tax receipt for the value of the assets, reduced by the discount factor discussed above.

Charitable Foundations

It is also possible to establish a charitable foundation: a permanent, income-earning endowment fund. There are two general types of charitable foundations: public or community foundations, where donations are pooled and managed by professional money managers, and the income earned is used to support a broad range of charities; and private foundations that may be established by an individual by way of a trust or corporation to support his or her favourite charities.

A private foundation allows an individual complete control over how foundation assets are invested and which charities are supported. If a private foundation is established during the founder's lifetime, he or she can participate in the charitable giving process and imbue the foundation with his or her personal vision for philanthropic giving, which process can continue indefinitely following the founder's death under the control of successor director(s) or trustee(s). Advantages of a private foundation include flexibility with regard to personal philanthropic objects (there is no requirement to commit to giving to charities in existence at the time the private foundation is established) and retention of control over the decision-making process.

Private foundations have an annual disbursement quota, requiring the foundation to spend a specific percentage of the value of its assets not used directly in charitable activities or administration on charitable activities or gifts to other charities each year. In general, the disbursement quota for a private foundation with assets that are not used directly in charitable activities or administration is 3.5% of the average value of its property up to $1,000,000 and 5% of the portion of property exceeding $1,000,000.

For the person who may not wish the additional complexity of establishing a private foundation and its continuing responsibilities, a public or community foundation may provide a ready solution so that the person can both satisfy a philanthropic objective and tailor his or her focus and degree of involvement. As a donor to a public or community foundation, you can make your gift in the form of a named fund, or you can contribute to an existing fund. If a person wishes to select his or her own charities, a donor-advised fund can be established whereby the person individually advises on the charities that he or she wishes to support. A donor can gift private company shares to a private foundation, but detailed rules apply, including generally that the private foundation must sell the private company shares to a third party within five years for a tax receipt to be issued. Advisory "Charitable Giving Through a Private Foundation" further explores charitable giving through a private foundation.

CONCLUSION

If you have a charitable intent, that intent can be made a reality either during your lifetime or upon death. If you are interested in exploring charitable giving, please contact us so that we may discuss the options available to you to ensure that your charitable objectives are optimally achieved.

The comments offered in this Client Advisory are meant to be general in nature, are limited to Ontario law and are not intended to provide legal advice on any individual situation. Before taking any action involving your individual situation, you should seek legal advice to ensure it is appropriate to your personal circumstances.

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