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COMMENT

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CHARITABLE GIVING OF CORPORATE-OWNED LIFE INSURANCE

Life insurance is a valuable asset for charitable giving because it allows a donor to make a charitable bequest without depleting the donor's estate assets. It also provides the opportunity to magnify the size of a charitable gift.

All too often, we tend to think of charitable giving with life insurance from an individual's perspective. This type of giving can, however, be accomplished when life insurance is owned by a corporation. Why would a corporation want to complete a charitable gift? Individual shareholders might cause their corporation to complete a charitable donation because the corporation has the capital necessary to complete the gift. Alternately, the corporation might be a central entity within a family unit and a gift from the corporation would address the family's planning objectives.

The following are a few examples of how charitable giving with corporate-owned life insurance might be accomplished.

Gift of the Life Insurance Policy

A corporation could gift a new or existing life insurance policy. Generally, the gift of the life insurance policy results in a charitable gift being recognized for an amount equal to the fair market value of the policy. There are, however, two exceptions to this rule of thumb - if the policy was acquired in the last three years, or if it was acquired within the last 10 years and it is reasonable to conclude that one of the main purposes for acquiring the property was charitable giving. Falling within one of these two exceptions means the value of the charitable gift is recognized at the policy's adjusted cost basis.

A policy's adjusted cost basis is available from the insurance carrier. Determining the fair market value of an existing policy can be complex and typically should be established by a qualified professional who will consider information specific to the policy.

Consider the example of Paul who owns 100 percent of PQR Company Limited (PQR), which owns a life insurance policy on Paul's life. The policy was acquired nine years ago for the purpose of securing a term loan incurred by the company. PQR no longer requires the insurance for its original purpose and Paul feels that his estate plan is sufficiently balanced without this policy. As such, he sees the policy as an ideal asset for charitable giving and has decided to have PQR gift the policy to his favorite charity.

Recall that PQR acquired the policy more than three years ago and its original purpose was not for charitable giving. Therefore, the value of the policy for purposes of the charitable receipt should be the fair market value of the policy. If Paul's health has changed or the policy has a fixed cost (sometimes referred to as level cost), the fair market value could be higher than the policy's cash surrender value.

From PQR's perspective, the company has disposed of the policy for deemed proceeds equal to the greater of the:

(1) cash surrender value of the policy;

(2) adjusted cost basis of the policy; and,

(3) fair market value of any consideration received on the transfer.

In a gifting situation, there is usually no consideration, so deemed proceeds will be the greater of cash surrender value (number one above) and adjusted cost basis (number two above). Note that PQR's deemed proceeds are not linked to the amount of the charitable receipt, which should be issued for the policy's fair market value.

If premium payments associated with the policy are to be continued after the donation, the charity can issue a charitable receipt to PQR for any payments the corporation makes subsequent to the charity's assumption of ownership.

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There is no charitable receipt issued upon Paul's (the life insured's) death under the strategy discussed above because receipts were issued during his lifetime and the charity is the owner of the policy at the time of Paul's death. It should be noted that corporate gifts qualify for a tax deduction rather than a tax credit as is the case with individual donations.

Gift of the Life Insurance Benefit

An alternative when utilizing life insurance for charitable purposes is to donate the death benefit associated with the policy. Under this strategy, the charitable receipt arises at the time of the life insured's death.

Planning with a corporate-owned life insurance policy under this strategy is more complex. The charity should not be named as the beneficiary of the policy. Why? There is no donation receipt available and the corporation is not entitled to a credit to its capital dividend account when the life insurance proceeds are paid. In addition, there is the potential the CRA may assess a shareholder benefit depending upon the circumstances.

Instead, a charitable gift could be achieved by having the:

(a) shareholder's will instruct the executor to cause the company to make the charitable gift upon the death of the life insured;

(b) company pay a capital dividend to the shareholder's estate, who would then make the donation pursuant to the will and become the recipient of the charitable receipt; or,

(c) deceased's estate donates fixed-value preferred shares of the company to the charity and has the company use the life insurance proceeds to purchase (redeem) the shares from the charity.

In (a) above, the company makes the gift and can claim a tax deduction for the amount of the gift, but with the limitation that the deduction cannot exceed 75 percent of the corporation's net income. Any portion of the gift made but not claimed because of the 75 percent limitation, or because the corporation opts not to claim an eligible amount, can be carried forward and claimed in any of the five subsequent taxation years of the corporation.

In (b) and (c) above, the claim for the charitable tax credit will depend on whether the gift was completed from the Graduated Rate Estate (GRE) of the deceased. A gift completed through the GRE can be claimed on the deceased's terminal tax return, the deceased's tax return from the year prior to death, or any prior tax return of the GRE. A gift made from a testamentary trust that is not a GRE can be claimed only in the year the gift is made or in any of the five subsequent years.

Charitable gift planning entails looking at the individual's overall situation and creating a charitable strategy that best fits the circumstances. Corporate-owned life insurance should not be overlooked for charitable gift planning, but care should be observed to ensure the arrangements do not inadvertently create an unintended consequence.

JOINT TENANCY IN THE SPOTLIGHT

Joint tenancy is an important part of estate planning because it allows individuals to legally pass property to another person upon death outside of their estate. This avoids the need to probate that asset in order to transfer ownership, eliminates probate fees on the asset, and provides a certain level of privacy with respect to the asset.

However, property held in joint tenancy has come under the spotlight in recent court cases. Typically, the beneficiaries of an estate will argue that the surviving joint owners received the property as trustees on behalf of the estate and a gift was never intended. As such, the argument is that the asset held in joint tenancy should form part of the deceased's estate like any other asset held by the deceased at the time of death.

On the other hand, the joint owner(s) may argue the testator intended to make a gift when the property was registered in joint tenancy. The challenge lies in the level of documentation, or rather lack of documentation, created at the time of the transfer and the courts are often called upon as decision-makers to ascertain the testator's original intentions.

Court decisions are based on the facts of each distinct situation. The issue of joint tenancy arose in a recent Ontario Court of Appeal case, *Jansen v. Niels*. A summary of the important facts of this case are as follows:

- Theadora Niel's will divided her estate into three shares: one for her son Richard, one for her daughter Marjolein, and one to be divided between her son Arend (Frank) and his children. At the time of making these arrangements, Marjolein and Richard had a strained relationship. In addition, while Theodora and Marjolein were once close, their relationship began to deteriorate at the time Theodora began a relationship with a live-in companion.
- In 2004, Theadora put her home up for sale and Marjolein immediately wrote a letter to her mother, strongly objecting to the house sale because she believed the home had been promised by Theadora to the three children.
- Theadora did not respond directly to Marjolein about the letter and never again spoke with her.
- Two days after receiving Marjolein's letter, in December 2004, Theadora wrote a new will removing Marjolein as executrix but leaving her as a one-third beneficiary of the estate.
- Theadora subsequently added a codicil to her will to set out arrangements should she pass before taking title to her new home. The codicil provided that the new home would pass to Richard and the purchase would be funded by her estate.
- A few months after taking title to her new home in 2005, Theodora transferred title of the property from sole ownership to herself and Richard as joint tenants. In 2007, title was transferred to Theadora, Richard and Richard's wife, Ingrid, as joint tenants. An addition to the house was built for Richard and Ingrid to live in.
- In 2009 Richard and Ingrid separated. In their separation agreement (not prepared by a lawyer) Richard confirmed he would transfer his interest in the home to Ingrid upon his mother's passing.
- In 2010, after being diagnosed with cancer and a short remaining life expectancy, Theadora asked Ingrid to care for her, which she did until her passing.
- After being diagnosed with cancer, Theadora also contacted one of the two executors of her will seeking assurance that the home would pass to Richard and Ingrid outside of her estate.
- Theadora passed away on November 22, 2010.
- On October 31, 2011, Richard and Ingrid signed an amending agreement to their 2009 separation agreement (this time prepared by a lawyer) which stated the couple jointly owned the property and that Richard would transfer his interest in the home to Ingrid. On December 12, 2011, the transfer was registered and title was transferred into Ingrid's name alone.
- Two months later, in February 2012, Marjolein brought an application seeking a declaration that the property was part of Theadora's estate.

Marjolein's application was rejected by the application court judge and later by the Court of Appeal.

One of Marjolein's arguments was that the title to the property was held as tenants in common and not as joint tenants because Richard agreed to transfer his

interest in the property to Ingrid. Marjolein suggested this demonstrated that the parties wanted to sever their joint tenancy arrangement.

The Court of Appeal reviewed the three criteria, as set out in *Hansen Estate v. Hansen*, that could be used to determine whether the parties to a joint tenancy arrangement wanted to sever the relationship and become tenants in common. The three criteria for severing a joint tenancy are:

1) One of the joint owners acting unilaterally with respect to his or her own share, such as selling or encumbering it;
2) The creation of a mutual agreement among all of the co-owners to sever the joint tenancy and become tenants in common; and,
3) Any course of action sufficient to intimate that the interests of all owners are mutually treated as constituting the interest as tenants in common.

Marjolein argued that Richard's agreement to transfer his interest in the house to Ingrid was indicative of a joint owner treating his interest as a tenant in common over which he had undisputed control. The Court of Appeal disagreed primarily because the separation agreement only indicated an intent to transfer title at some point in time in the future and this was not sufficient to meet the criteria outlined above. The court also noted that the separation agreement was ambiguous and if there was a conveyance it would only sever Richard's one-third interest in the joint tenancy. Ingrid and Theodore would remain joint tenants on their shares with Richard as a tenant in common. Therefore, upon Theodora's death, her interest in the property would pass to Ingrid.

Alternatively, the court concluded that if the separation agreement did not sever Richard's interest in the property, then the joint tenancy continued and Theodora's one-third interest passed to Richard and Ingrid through the right of survivorship.

Another of Marjolein's arguments was that Theadora did not intend to make a gift of the property when she registered it in joint tenancy with Richard and Ingrid. This would mean that Richard and Ingrid held the property in trust for the estate, where the property would be divided equally among Theadora's three children.

The application judge found, and the Court of Appeal reaffirmed, that there was sufficient evidence to demonstrate that Theadora clearly intended to make a gift to Richard and Ingrid. In arriving at this conclusion, the courts considered Theadora's instructions to her lawyer when she first registered the property in joint title with Richard; the signing of a codicil to clearly depict the house was not to form part of her estate; the absence of any request to change title to tenants in common; and, the call to one of her executors seeking assurance that the house would pass to Richard and Ingrid upon her death.

While every case is unique and the courts make decisions based on the evidence, the take aways from this case include:

- strong documentation can help provide the courts with clarity of the testator's intentions; and,
- legal advice will help to minimize unintended conflicts especially when attempting to change title of property in divorce or separation documents.

Joint tenancy is a powerful estate planning tool. However, if not properly documented, misunderstandings can arise that can be hurtful to the family and expensive to settle.

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