WEST COAST ENVIRONMENTAL LAW

GIVING IT AWAY

TAX IMPLICATIONS OF GIFTS TO PROTECT PRIVATE LAND

ANN HILLYER AND JUDY ATKINS

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West Coast Environmental Law strives to empower citizens to participate in forming policy for, and making decisions about, protecting our environment. From the local to international level, our work supports the right of the public to have a voice in how we share our earth. Since 1974, we have been providing free legal advice, advocacy, research and law reform services. And through our Environmental Dispute Resolution Fund, we have given away over $2,000,000 to hundreds of citizens' groups across BC to help them solve environmental problems in their own communities.

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PREFACE

The West Coast Environmental Law Research Foundation (WCELRF) is a non-profit charitable society devoted to legal research and education aimed at protection of the environment and promotion of public participation in environmental decision making. It operates in conjunction with the West Coast Environmental Law Association (WCELA) which provides legal services to concerned members of the public for the same two purposes.

This *Guide* provides information to government agencies and conservancy organizations about the potential tax benefits and tax liabilities of gifts of land, interests in land and other types of property where the gift is made for the purpose of increasing the protection of ecologically significant spaces or environmentally important features of land. It is a guide to the laws, regulations and policies governing taxation issues that arise when a landowner donates private land or grants a conservation covenant on land to a government agency or a non-government organization that agrees to protect the land in perpetuity.

This *Guide* was first published in 2000. Since that time there have been a number of changes to the laws, regulations and policies resulting in additional incentives and greater flexibility for landowners wishing to make donations of land or interests in land for conservation purposes. This edition of the Guide includes those changes, current to March 1, 2004.

Readers are reminded that this *Guide* is educational only and does not constitute legal or tax advice. The examples provided are simplified for the purpose of illustrating specific points in the Guide and do not reflect the complexities taxpayers must deal with in real situations. The legal and tax implications of any transaction depend on the circumstances of the transaction as a whole and on the landowner's individual circumstances. All parties involved in the legal protection of a specific parcel of land are strongly urged to seek legal and tax advice at their earliest opportunity.

This *Guide* is also available electronically on our web site at http://www.wcel.org/. West Coast intends to periodically update the *Guide* when significant changes are made to the *Income Tax Act* or other relevant legislation. These updates will be available on our web site. To register for our electronic announcement of *Guide* updates, send your email address to taxguide@wcel.org.

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The views expressed are those of the authors and the West Coast Environmental Law Research Foundation. Any errors and omissions are, of course, solely the responsibility of the authors.

CONTENTS

PREFACE III

ACKNOWLEDGMENTS IV

CONTENTS V

CHAPTER 1 – INTRODUCTION 1
- The purpose of this Guide 1
- Getting professional advice 2
- A word about conservation covenants 2
  - Why it is a good tool to protect private land 3
  - Examples of applications 3
- How tax rules are evolving 4
- Organization of this Guide 4

CHAPTER 2 – INCOME TAX ASPECTS 5
- Background 6
- Explanation of income tax 7
  - Income tax legislation 7
  - Canada Revenue Agency 7
  - Interpretation of *Income Tax Act* 8
  - When income tax is payable 9
  - How much tax is payable 11
- Gifts under the Income Tax Act 12
  - Meaning of “gift” and “property” 12
  - Split receipting 13
  - Tax credits or deductions for charitable gifts 15
  - Types of gifts 17
  - Income inclusion or capital gain 18
- Tax treatment of capital property 19
  - Calculation of gains and losses 19
  - Gifts of capital property 21
  - Capital gains exemptions 24
- Gifts of land and interests in land 27
  - gifts of land that is capital property 27
  - gifts of inventory land 29
  - Ecological gifts 30
  - Calculating original cost of a conservation covenant 35
- Valuation of land 38

Basis of appraisal ... 38
The appraisal process ... 39
Problems appraising conservation covenants ... 40
Before-and-after approach ... 40
Valuation of ecological gifts ... 41
Other kinds of gifts ... 43
Cash gifts ... 43
Gifts of securities ... 43
Gifts of personal-use property ... 43
Possible adverse consequences ... 44
Tax considerations for recipients of gifts ... 45
Charitable status ... 45
Disbursement Quotas ... 46
Loss of charitable status ... 47
Donation receipts ... 48
Special taxes ... 48
Goods and services tax (GST) ... 49
Examples of tax consequences of gifts ... 49

CHAPTER 3 – GIFT PLANNING ... 54
Benefits of gift planning ... 54
Providing for dependants ... 55
Will preparation ... 55
Taxes payable in the year of death ... 56
Capital property ... 56
Registered retirement savings plans (RRSP) ... 57
Probate fees ... 58
Giving property away during life ... 59
Outright gifts vs. trusts ... 59
Kinds of planned gifts ... 61
Examples of planned giving ... 66

CHAPTER 4 – PROPERTY TAX ... 69
What is property tax ... 69
Who administers the property tax system ... 70
Property assessment — British Columbia Assessment Authority ... 70
Levying property taxes — taxing authorities ... 70
Assessing the value of property ... 71
Rules relating to conservation covenants ... 73
Property tax exemptions ... 74
Natural area protection tax exemption ... 75
Determining the tax rate ... 76
Summary of property tax considerations for ecologically sensitive land ... 77

CHAPTER 5 – PROPERTY TRANSFER TAX ... 78
What it is ... 78
When it is payable ... 78
Exemptions relating to conservation efforts ... 79

APPENDIX 1 – GLOSSARY 80
APPENDIX 2 – ORGANIZATIONS TO CONTACT FOR MORE INFORMATION 83
National government and non- government organizations 83
British Columbia government and non-government organizations 84
REFERENCES AND RESOURCES 87
Useful publications 87
Useful websites 89
Canada 89
United States 89

CHAPTER 1

INTRODUCTION

Although the vast majority of land in British Columbia is owned by the Crown, subject to aboriginal rights and title, the remaining private land has ecological, cultural and heritage values of such importance that it is easy to forget private land makes up only about five percent of the land base in the province. These are values that communities frequently want to preserve and protect.

For example, many areas with high biodiversity values and significant ecological features are located in the southern portions of the province on privately owned land. In all parts of the province, humans were drawn to settle in valley bottoms, estuaries and other scenic areas with high environmental values. Much of this area is now privately owned. As the human impact on these critically important areas continues to grow, concerned citizens and conservancy organizations are increasingly focusing their efforts on ways to provide permanent protection for those areas.

THE PURPOSE OF THIS GUIDE

When a landowner wants to protect ecologically special property, there are several options available. For example, the landowner might decide to grant a conservation covenant to a conservancy organization or government organization. Alternatively, the landowner might decide to make a gift of the land itself to a conservancy organization or to the government. Other potential donors may decide to make a gift of cash or property other than land to a conservancy organization to assist the organization in carrying out its conservancy activities. Early in the process of making the decision about whether to make a gift — and what type of gift is appropriate in the circumstances — the donor needs to consider all potential tax implications.

Even though most people readily accept that they must deal with personal tax matters, at least on an annual basis, the very notion of tax consequences associated with protecting private land can send a chill into the heart of the most altruistic donor. There are also tax implications for those agencies and organizations that receive donations. However, the tax consequences often include significant tax benefits.

This *Guide* is intended to provide landowners, potential donors, conservancy organizations and other recipients of gifts, professionals and others interested in protecting important

ecological spaces with information about the possible tax consequences of protecting private land:

- to ensure they have an accurate introduction to the relevant tax aspects of these transactions;
- to illustrate that not all tax consequences are negative — indeed there are tax benefits in many circumstances;
- to ensure landowners and conservancy organizations understand the need for getting their own tax advice from tax professionals early in the process; and
- to offer options that may assist in overcoming tax consequences that appear to pose obstacles to protecting the land.

While this *Guide* focuses primarily on protecting natural values of land, the gift strategies and tax implications discussed in the *Guide* are relevant to other protection objectives as well, such as protecting heritage and cultural values of land.

GETTING PROFESSIONAL ADVICE

This *Guide* provides educational information only. It does not constitute legal or tax advice in connection with specific properties or specific transactions. It is intended to alert readers to tax related issues so they know to seek tax and legal advice from an appropriate professional. It is essential that landowners considering legal measures to protect their private land and conservancy organizations considering accepting gifts of land, conservation covenants or other property consult with legal and tax advisors at the earliest opportunity.

A WORD ABOUT CONSERVATION COVENANTS

This *Guide* provides general information about the tax consequences of making charitable gifts primarily to conservancy organizations. However, there is a significant focus on giving gifts of land and interests in land, in particular, conservation covenants. Therefore, a brief description of conservation covenants is in order.

A conservation covenant is a statutory instrument or legal tool created by section 219 of the *Land Title Act.*[1] It was designed for conservation purposes and provides the legal basis for protecting a broad range of ecological, cultural, heritage and other values.

Until 1994, only a provincial or local government body could hold a conservation covenant. The *Act* was amended that year to allow a conservation covenant to be held by any person designated by the Minister of Environment, Lands and Parks.[2] In practice, this means that a non-governmental conservancy organization such as a local conservancy or

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[1] *Land Title Act*, RSBC 1996, c. 250.

[2] *Land Title Act*, RSBC 1996, c. 250, s. 219(3)(c). Currently, the Minister of Sustainable Resource Management is responsible for designating conservation covenant holders.

land trust or a large provincial or national conservancy group can now hold a conservation covenant. A conservation covenant also can be held jointly by two or more organizations, one of which can be a provincial or local government agency. Since the 1994 amendment, there has been an explosion of interest in using conservation covenants to protect ecologically important private land in British Columbia.

Essentially, a conservation covenant is a voluntary, written agreement between a landowner and a conservancy organization. It can cover all or just part of a parcel of property. In the agreement, the landowner promises to protect the land in ways that are described in the covenant. For instance, the landowner might agree not to subdivide the land or to provide specific protection for important habitat. The conservancy organization holds the covenant and can enforce it if the owner does not abide by its terms. The conservation covenant is registered on title to the property in the British Columbia Land Title Office under section 219 of the *Land Title Act*. This ensures that the terms bind future owners of the land, not just the current landowner, since the conservation covenant is intended to last permanently.

WHY IT IS A GOOD TOOL TO PROTECT PRIVATE LAND

The language in the legislation allows conservation covenants to be used in a wide range of circumstances. In addition, since a conservation covenant is a written agreement between the parties to the covenant, it is a flexible instrument. A conservation covenant is an effective tool because:

- it can be individually tailored to address the particular ecological features of the land on which it is registered and the specific conservation objectives of the parties;
- a landowner can grant a covenant covering only those areas of the landowner's property with special significance and can use the remainder of the property without restriction; and
- since 1994, conservation covenants can be held by non-governmental conservancy organizations that focus their time, energy and expertise on protecting ecologically important parcels of land throughout the province; this allows these organizations to harness the considerable interest that exists in communities in protecting many of the special spaces in their area and relieves some of the burden on government to protect land.

EXAMPLES OF APPLICATIONS

Conservation covenants can be used in a variety of ways to protect private land:

- to protect ecologically valuable features of the land;
- to protect critical habitat for species at risk;
- to provide buffer zones next to parks, wetlands or other environmentally sensitive areas;
- to protect sensitive areas in newly subdivided developments;
- to limit forestry activity on private land to ecologically sustainable forestry;

- to create trail systems and greenways through a number of parcels of adjoining land;
- to protect riparian habitat from logging, clearing or other development; and
- to protect important heritage and cultural sites.

These are just some examples. While there are many types of important values that may be protected by the use of conservation covenants, this *Guide* focuses on protecting the ecological values of land.

HOW TAX RULES ARE EVOLVING

Tax rules are constantly evolving. The tax rules applicable to gifts made to protect the environment have changed over the past few years. They now offer greater encouragement for the protection of the environment and, more particularly, the protection of ecologically significant lands. It is anticipated that they will continue to evolve as governments further recognize the benefits of encouraging the legal protection of private land and land stewardship through appropriate taxation policy.

This *Guide* explains the current laws, regulations and policies related to various forms of gifts that are made to protect private land. When using the *Guide*, be sure to consult your tax professional for information about any recent changes in this area of the law.

ORGANIZATION OF THIS GUIDE

The remainder of this *Guide* covers the following topics:

- income tax issues, including how gifts are treated under the *Income Tax Act*,[3] tax credits and deductions for gifts, the tax treatment of capital property, capital gains, gifts of land and interests in land, gifts of other property, and a brief mention of GST;
- gift planning;
- property tax; and
- property transfer tax.

[3] RSC 1985 (5th Supp.), c. 1.

CHAPTER 2

INCOME TAX ASPECTS

Donating land or other interests in land, including conservation covenants, to protect and conserve the land may have income tax consequences. Similarly, there may be income tax implications arising from cash donations and donations of other property in kind. Donations may give rise to additional tax liability but also may result in tax benefits, depending on the circumstances.

Generally speaking, when you give a gift to a recipient qualified under the *Income Tax Act* to issue tax receipts (for example, the federal or provincial government, municipalities, and registered charities), you will receive a tax receipt for the value of the gift. You may then claim a tax credit. Corporations can claim a tax deduction. The size of the tax credit is based on both the value of the gift and your net income for the year. The credit is non-refundable and can only be used to offset any income tax otherwise owing.

The tax credit is subtracted from the amount of federal income tax that you must otherwise pay for the year. The amount of provincial income tax payable is calculated on the basis of the amount of federal tax payable after subtracting the tax credit. The result is a reduction in the amount of both federal and provincial income tax otherwise you would otherwise pay.

The tax credit is calculated as a percentage of the value of the gift up to a maximum of 75% of the donor's net income for tax purposes for the year. For example, you donate $100,000 cash to a qualified recipient. Your net income for the year is $60,000. You receive a tax receipt for $100,000. The maximum amount on which you can calculate a tax credit in the year of the gift is $45,000, or 75% of your net income of $60,000. After calculating the tax credit, you may deduct the credit from federal tax otherwise payable.

One exception to the 75% limitation is gifts that qualify under the *Income Tax Act* as "ecological gifts." There is no limit to the amount of ecological gifts eligible for a tax credit or deduction. Ecological gifts are gifts of ecologically sensitive land that are certified by appropriate officials.

Any part of the value of the gift that you do not choose to claim in the year the gift is made or are not able to claim because of the income limitation may be carried forward for up to five years. You may use any amount of the balance remaining in each of the following five years to claim a tax credit. This allows you to allocate the amount of the value of the gift to maximum tax advantage based on your income. In the example above, if you claimed the

maximum tax credit in the year of the gift, $55,000 could be carried forward for up to five years.

A gift is considered a disposition under tax legislation and is deemed under the legislation to give rise to proceeds of the disposition as if it had been sold. In other words, even though you did not receive any money as a result of the donation, for tax purposes, you are considered to have received payment for the property given away. If the gift is of capital property other than cash, for example, land, and the property is worth more at the time of the gift than it was at the time you acquired it, you may realize a capital gain that attracts tax.

You must include 50% of the amount of any capital gain in your income for the year. However, the tax on this additional income generally will be more than offset by the tax credit that you will be able to claim, based on the tax receipt for the value of the gift.

In the case of a gift of capital property that has increased in value and would therefore give rise to a capital gain, you can designate as the value of the gift any amount between your cost of the property and the fair market value of the property at the time of the gift. The lower the amount designated, the lower the amount of the gain. However, the tax benefit will also be for a lower amount and the corresponding tax credit will be less. There may be circumstances in which you would want to designate a lower value, for example, if you were facing a clawback of income-based benefits such as old age pension benefits.

It will likely be necessary for you to have property appraised to determine its fair market value at the time of the gift. Determining the value of the gift is a necessary part of identifying the tax consequences of making the gift. The amount of the tax receipt is based on the value assigned to the gift. So too is the calculation of any gain deemed to have arisen at the time of the gift.

Determining the value of many kinds of gifts is relatively straightforward although it may require the services of a qualified appraiser. However, it may be more difficult to determine the fair market value of covenants and easements.

If land or a covenant is sold rather than donated to the Crown, a conservancy organization or any other purchaser for conservation or any other purposes, the sale is a disposition like any other and the proceeds taxed accordingly. There would be no offsetting tax credit in these circumstances.

BACKGROUND

Donating land or placing a covenant on land to protect it may have income tax implications. This also may be the case with cash donations and donations of other property in kind. It is important for potential donors to consider the tax consequences of gifts of both land and other kinds of property. The next section of this ***Guide*** offers an explanation of the Canadian taxation system, particularly in relation to the tax treatment of gifts.

NOTE: This *Guide* provides introductory, educational information only. The examples given are hypothetical and have been simplified to explain the basic concepts. This *Guide*

does not constitute legal or tax advice in connection with specific transactions. The tax implications of any transaction depend on the circumstances of the transaction as a whole and on the taxpayer's individual circumstances and cannot be considered in isolation. It is essential that donors and recipients consult with legal and tax advisors at the earliest opportunity.

EXPLANATION OF INCOME TAX

Income taxes are levied to generate revenue to finance government operations. The amount of revenue raised by income tax is equal to the tax base multiplied by the rate of tax. Both who is taxable and what kind of income is taxable determine the tax base. The Canadian Constitution[4] authorizes both the federal Parliament and the provinces to impose income taxes. The provinces are restricted to direct taxation within the province for the purpose of raising revenue for provincial purposes.

INCOME TAX LEGISLATION

Income tax law derives from

- the federal *Income Tax Act*[5] and the various provincial tax acts,
- the federal Income Tax Regulations,
- tax treaties,
- the Income Tax Application Rules[6], and
- case law.

The *Income Tax Act* is the primary source of income tax law in Canada. The federal Cabinet passes *Income Tax Regulations* under the authority of the *Income Tax Act.* British Columbia also has its own *Income Tax Act.*[7]

CANADA REVENUE AGENCY

The Canada Revenue Agency (CRA) (formerly Revenue Canada and Canada Customs and Revenue Agency) is the federal department primarily responsible for the administration of the *Income Tax Act* and for its enforcement. The *Income Tax Act* defines the "Minister" as the Minister of National Revenue.[8] In its administration of the *Income Tax Act*, CRA generates a variety of administrative information including advance rulings, interpretation bulletins, information circulars, and technical interpretations.

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[4] *Constitution Act, 1867* (U.K.), 30 & 31 Vict., c. 3.

[5] RSC 1985 (5th Supp.), c. 1.

[6] RSC 1985 (5th Suppl), c. 2. The *Income Tax Application Rules* provide largely for the transition from the pre-1972 tax legislation to the current tax legislation.

[7] *Income Tax Act*, RSBC 1996, c. 215.

[8] *Income Tax Act*, s. 248(1).

INTERPRETATION OF *INCOME TAX ACT*

The *Income Tax Act* is a complex statute. Many aids to its interpretation exist. The provisions of the *Income Tax Act* are often litigated and there has been a great deal of consideration of the *Income Tax Act* by the courts. These court decisions almost always consider the application of the provisions of the *Income Tax Act* to a particular situation. While court decisions are useful as a guide to interpreting the law, each particular situation or transaction involves different facts. This may materially change the application of the law to the situation.

As noted above, CRA generates explanatory information about the *Income Tax Act* and other tax legislation.

- CRA gives advance rulings in relation to particular proposed transactions. These rulings are given in relation to the legal aspects rather than the factual aspects of transactions.
- Interpretation bulletins (ITs) represent CRA's administrative position on various income tax matters.[9]
- Information circulars (ICs) generally deal with administrative matters of a procedural nature such as tax collection, tax avoidance, elections and installment payments.

None of these sources of administrative information generated by CRA has the force of law. Although they are not legally binding, they can be of assistance where there is uncertainty about the meaning of the tax legislation.[10]

Other aids to interpretation of tax legislation include the following:

- technical notes and explanations issued by the Department of Finance to explain new legislation; and
- generally accepted accounting principles that can be important where tax legislation is silent about a particular issue.

Finally, the *Income Tax Act* must be interpreted in light of international tax conventions or treaties that Canada has with other countries to reduce the incidence and effect of double taxation. These tax conventions must be considered when looking at the tax implications of cross-border transactions such as a donation of land by an American resident to a Canadian conservancy organization. A detailed discussion of non-resident taxation issues is beyond the scope of this *Guide*. Those contemplating a cross-border transaction should consult their tax advisors.

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[9] For example, IT-120R4 provides CRA's interpretation of the provisions of the *Income Tax Act* relating to principal residences.

[10] *Nowegijick v. The Queen*, 83 DTC 5041.

WHEN INCOME TAX IS PAYABLE

Who is taxable

Individuals and corporations are taxable unless exempt from taxation.

Partnerships are not taxable in their own right. The partnership is treated as a conduit for income and individual partners are taxable.

Trusts are taxable in their own right except that a trust is generally treated as a conduit to the extent that income is paid or payable to the beneficiaries of the trust.[11]

The following entities are among those exempt from the payment of tax:[12]

- municipal authorities;
- corporations owned by the Crown or a municipality;
- registered charities;
- non-profit corporations for scientific research and experimental development;
- labour organizations;
- non-profit organizations; and
- various kinds of trusts including a qualifying environmental trust, formerly known as a mining reclamation trust.

What is taxable

Income tax is a tax on income. Income represents only gains or profits that are realized. It does not include the source of the income, such as the value of property that produces income. Nor does it include any increase in value of property that is not realized, for example, through the sale of the property.

Because income represents only gains or profits, income is what remains after deducting any amounts spent to earn the income. Employment income, however, is taxed on a gross rather than net basis. Only those deductions specifically authorized in the *Income Tax Act* can be deducted from employment income.[13]

In Canadian tax law, income is classified by its source. For example, the *Income Tax Act* differentiates among

- income from an office or employment,
- income from a business,

[11] *Income Tax Act*, s. 104.

[12] *Income Tax Act*, s. 149(1).

[13] See, for example, *Income Tax Act*, s. 8(1).

- income from property, and
- capital gains.

Other taxable sources of income include

- pension benefits,
- death benefits,
- alimony and maintenance,
- scholarships,
- research grants, and
- prizes.

Each source of income is subject to its own set of rules under the *Income Tax Act* and is taxed according to those rules.

Some gains and additions to a person's wealth such as gifts, inheritances, and windfalls (for example, lottery winnings) are excluded from income for tax purposes. Some other kinds of income are exempt from taxation.[14]

A taxpayer pays tax only on his or her taxable income.[15] The *Income Tax Act* distinguishes between

- total income — the total of all amounts received in the year as income within the meaning of the *Income Tax Act*,[16]
- net income — total income less certain allowable deductions such as professional fees, RRSP contributions, and child care expenses, and
- taxable income — net income less certain allowable deductions such as capital losses and capital gains deductions.

The tax system permits some exemptions, deductions from income (that is, income net of expenses), and tax credits in the calculation of taxable income.[17] These are in addition to the deductions from income of expenses paid out to earn the income or permissible deductions from income from employment. Some of these additional deductions and credits — for example, the financial incentives for taxpayers who contribute to political, charitable, and other public service organizations and the principal residence exemption — will be discussed in detail in this ***Guide***.

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[14] *Income Tax Act*, s. 81.

[15] "The taxable income of a taxpayer for a taxation year is the taxpayer's income for the year plus the additions and minus the deductions permitted by Division C." (*Income Tax Act*, s. 2(2). Division C contains the provisions relating to the computation of taxable income).

[16] In the case of total income from a source other than employment, the income is net of expenses required to earn the income.

[17] There are a number of credits against the amount of tax otherwise payable available to individuals, depending on the circumstances. In addition to the basic personal tax credit and tax credits in relation to the amount spent for tuition and medical expenses, tax credits are available for charitable donations (see *Income Tax Act*, s. 118.1). This kind of tax credit will be discussed in greater detail in the *Guide*.

An individual who is a Canadian resident, or deemed to be a Canadian resident, is taxed on all of his or her income from both inside and outside Canada. Non-resident individuals are taxed in Canada only on income from Canadian sources.

Time at which tax is payable

Canadian taxpayers are required to pay income tax on a yearly basis.[18] The taxation year may or may not coincide with the calendar year. The taxation year of an individual is the calendar year. The taxation year of a corporation is the corporation's fiscal year which may not be the same as the calendar year.

Two methods are used for calculating income from business or property — the cash method and the accrual method.

- Cash method. Amounts are included in income when received and expenses are deducted when paid. Income from employment is always calculated on this basis.
- Accrual method. Income is calculated for the period during which it has been earned, whether or not it has been received. This method is used to calculate income from a business or property.

HOW MUCH TAX IS PAYABLE

Federal tax rates for individuals vary from 16% to 29%[19] of taxable income. The rate increases as the income increases.[20] Provinces also impose income taxes. The provincial rates are calculated either at rates set out in the provincial legislation or as a percentage of the federal tax rate. Provincial rates vary from province to province. The provincial tax rate in British Columbia for the 2002 and subsequent taxation years varies from 6.05% to 14.7% of taxable income.[21] There also may be federal and provincial surtaxes imposed in addition to these amounts.

[18] *Income Tax Act*, s. 2(1).

[19] After 2001, these rates are indexed according to the formula contained in section 117.1 of the *Income Tax Act*.

[20] *Income Tax Act*, s. 117(2).

[21] *Income Tax Act*, RSBC 1996, c. 215, s. 4.1.

GIFTS UNDER THE INCOME TAX ACT

Property owners who make gifts of their land or an interest in their land, such as a conservation covenant, to government or non-profit organizations for the purpose of protecting and conserving the land will be faced with a number of tax consequences. There also are tax consequences of donating property other than land to charities.

Donating property, including land, might result in an increase in a taxpayer's income for the year. However, the tax system offers incentives through tax relief to those taxpayers, both individual and corporate, who donate to government or charitable, philanthropic, and other public service organizations. The tax relief generally takes the form of deductions from net income for corporations and non-refundable tax credits for individuals.[22] The result will usually be beneficial to the taxpayer.

MEANING OF "GIFT" AND "PROPERTY"

A gift is a voluntary transfer of property without consideration, that is, without the expectation of any benefit, advantage, right or privilege in return. The benefit or advantage might be in the form of cash, other property or services. The transfer must be voluntary. Generally, any obligation to transfer land, such as a court order, or, depending on the circumstances, a donation of park land required to obtain development or subdivision approval, would prevent the transfer from being a gift.

"Property" means property of any kind whatever, whether real or personal, and includes a right of any kind, a share of the capital stock of a corporation and the work in progress of a business that is a profession.[23] Conservation covenants fall within the meaning of property. Property, however, does not include services such as time, skills and effort.[24]

Until recently, to the extent that the person transferring property to another received some benefit or advantage in return for the transfer of property, that transfer was not a gift. For example, where a taxpayer sold property for an amount less than its fair market value, the portion of the value that was, in effect, a gift would not attract the tax benefits associated with gifts. This was true even if the sale was to an organization qualified under the *Income Tax Act* to receive gifts and give tax receipts. The introduction of "split-receipting" explained below has changed this.

The introduction of "split receipting" allows donors to receive some benefit in return for donating property and to receive a tax receipt for the amount that is a gift.

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[22] *Income Tax Act*, s. 110.1 (corporations) and 118.1 (individuals).

[23] *Income Tax Act*, s. 248(1) (property).

[24] Interpretation Bulletin IT-110R3, Part I, section 15(d), available on the web at http://www.ccra-adrc.gc.ca/menu/APAP-e.html.

SPLIT RECEIPTING

Draft amendments to the *Income Tax Act* issued December 20, 2002, but not yet enacted permit the issue of donation receipts in circumstances where an intention to make a gift is present but some benefit (or "advantage") is also received by the donor.[25] These proposed amendments permit the practice of "split-receipting", by which a qualified recipient can issue donation receipts reporting both the fair market value of property transferred to it and the "eligible amount of the gift", which is the difference between the fair market value of the property transferred and the value of any advantage to the donor. Under these amendments, the donor's capital gain is computed based on the fair market value of the property transferred, while the donor's donation tax credit or deduction is based on the eligible amount of the gift.

On December 24, 2002, CRA proposed guidelines on "split-receipting" to accompany the proposed amendments.[26] These guidelines may be followed even though the amendments to the *Income Tax Act* are not yet enacted.

Under the proposed amendments and guidelines split-receipting is allowed under the following circumstances:

- The transfer of property must be voluntary and the property transferred must have an ascertainable value. If the value of the advantage cannot be ascertained, no charitable tax deduction or credit will be allowed. The amount of the advantage is the value, at the time the gift is made, of any property, service, compensation or other benefit that the donor has received or is entitled to receive, either immediately or in the future and either absolutely or contingently, as partial consideration for, or in gratitude for, the gift.

- The recipient must be qualified to receive the gift.

- The advantage received or obtained by the donor must be identified and , as noted above, its value must be ascertainable.

- The value of the advantage or benefit to the donor and the eligible amount of the gift for which the donor may receive a tax deduction or credit must be recorded on the donation receipt together with the fair market value of the transferred property.

- The donor's intent to enrich the recipient of the gift must be clear.

The donor is presumed to have intended to enrich the recipient in circumstances where the value of the advantage given to the donor does not exceed 80% of the fair market value of the transferred property. Where the value of the advantage to the donor exceeds 80% of the fair market value of the transferred property, a gift would be recognized only in

[25] The draft amendments are available on the Department of Finance website at http://www.fin.gc.ca/toce/2002/02-107_1e.html

[26] The proposed guidelines are contained in Income Tax Technical News, No. 26 at http://www.ccra-adrc.gc.ca/E/pub/tp/itnews-26/itnews-26-e.pdf and http://www.fin.gc.ca/toce/2002/02-107_1e.html

circumstances where the donor satisfies the federal Minister of National Revenue that the transfer was made with intent to make a gift.

CRA also recognizes that recipients of gifts will sometimes give a token of gratitude or appreciation to the donor. These tokens will not, and have not historically, been regarded by CRA as an advantage or a benefit for the purpose of determining whether or not the value of the advantage or benefit received by the donor exceeds 80 % of the value of the gift. As long as the advantage received by the donor does not exceed the lesser of 10% of the value of the gift or $75, then the advantage is only a token of appreciation that will not be used to calculate the advantage received by the donor. However, if the token is either cash or something that may be easily redeemed such as a gift certificate, then the token must be included in the calculation of the donor's advantage gained by giving the gift.

Where property subject to a mortgage is donated, all relevant encumbrances and charges on the property will need to be taken into account in determining the value of the gift. For example, if a donor donates a piece of land worth $400,000 and the donee assumes an outstanding mortgage at market conditions on the property worth $200,000, then the donor will have received an advantage of $200,000. Thus, the donor is eligible for a donation receipt of $200,000 – the value of the land ($400,000) minus the value of the advantage to the donor ($200,000).

Mortgages may be "favourable" or "unfavourable". A favourable mortgage is one where the terms of the mortgage are better than the current market. An unfavourable mortgage is one where the terms of the mortgage are worse than the terms that could be obtained on a mortgage in the current market. For example, if the mortgage interest rate is higher than could be currently obtained, the mortgage would be unfavourable.

If the land in the above example were subject to an unfavourable mortgage, then the advantage received by the donor when the charity assumes the mortgage would be greater. For example, if the $200,000 mortgage had a high interest rate and the donor would have to pay a third party $250,000 to assume the mortgage, then the advantage to the donor would be $250,000 and the donor's donation receipt would be for $150,000 — the value of the land ($400,000) minus the value of the advantage to the donor of having the mortgage assumed by someone else ($250,000).

Example: Donor owns land with a fair market value of $500,000.

Donor transfers the land to X Conservancy and receives $300,000 in return for the transfer.

The eligible amount of the gift and the amount of the donation receipt is $200,000 – the value of the land ($500,000) minus the value of the advantage received by the donor ($300,000).

Example: Donor transfers land to X Conservancy.

The land is mortgaged for $200,000.

X Conservancy assumes the mortgage.

The assumption of the mortgage by X Conservancy is the only advantage to the donor from the transfer.

The land has a fair market value of $500,000.

The mortgage has an interest rate of 5% which is representative of the current market.

The eligible amount of the gift and the amount of the donation receipt is $300,000 – the value of the land ($500,000) minus the value of the advantage received by the donor ($200,000).

TAX CREDITS OR DEDUCTIONS FOR CHARITABLE GIFTS

An individual may claim a tax credit for charitable donations or gifts that fall within the meaning of "gift" and satisfy the criteria in the *Income Tax Act*. The value of the gift generally will be determined at the time the gift is given. The recipient will issue to the giver of the gift a tax receipt representing the value of the gift. The tax receipt must be included with the taxpayer's tax return. Determination of the value of the gift will be discussed in greater detail in the section on valuation.

Where a donor gives a gift to a recipient not qualified under the Income Tax Act to issue tax receipts, the donor will not be eligible to receive a tax receipt. The other tax consequences of the gift described in this Guide may still occur.

To give rise to a tax credit or deduction, the gift must be made to one of the types of entities or organizations specified in the *Income Tax Act*. These include[27]

- registered charities,
- Canadian municipalities,
- the United Nations or its agencies; and
- the federal or provincial Crown.

A "registered charity" is one that meets the criteria set out in the *Income Tax Act*.[28]

Unless otherwise indicated, the words "gift," "donation" and "charitable donation" will be used throughout the remainder of this *Guide* to mean a gift to a recipient qualified under the *Income Tax Act* to receive gifts and to issue tax receipts for the amount of the gift.

[27] *Income Tax Act*, s. 118.1(1) (total charitable gifts).

[28] See *Income Tax Act*, s. 248(1).

The tax credit for donations is calculated as a percentage of the fair market value of the donation in an amount not exceeding 75% of the individual's net income. The 75% limitation does not apply to ecological gifts or cultural gifts. Ecological gifts will be discussed in greater detail later in this *Guide*.

In the case of charitable gifts of capital property such as land, the amount against which a tax credit may be claimed is the total of

- 75% of the donor's net income plus
- 25% of taxable capital gains plus
- 25% of recapture of any capital cost, allowance arising as a result of the gift.[29]

In the year of death and the year preceding death there is no limit on qualifying gifts (including gifts made in a will). Gifts made in a will are deemed to have been made immediately before the testator died, that is, in the year of death.[30] In addition to claiming a tax credit in the year of death, the representatives of a deceased taxpayer can file an amended tax return for the taxation year preceding the year of death claiming a tax credit to the extent possible for any excess portion of a gift made in the year of death. CRA will refund tax previously paid.

Unused donations may be carried forward for up to five years and, in any of those years, deducted or a tax credit claimed to the extent they were not used in a previous year. Tax credits are non-refundable and may only be used to offset tax liabilities. In other words, if a taxpayer cannot or does not use the full value of donations within the time allotted, the taxpayer loses any remaining benefit. There is no carry forward period for gifts made in the year of death.

Because the tax credit is non-refundable, donors should seek professional advice as to how to maximize the value of the credit. For example, spouses should take into account both the size of their net income and the effect of federal and provincial surtaxes when considering which spouse should claim the donation.

The rate at which the credit may be claimed depends on the amount donated. Individuals receive federal tax credits in the amount of 16% of the first $200 of the total amount of charitable gifts in the year and 29% of any amounts over $200, subject to the limitations explained above.[31] The credit is a federal tax credit and reduces the amount of federal tax payable.

A similar provincial tax credit for charitable gifts is available in British Columbia.[32] In 2003, for example, the combined federal and provincial tax credit is 43.7% of donations in excess of $200.

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[29] *Income Tax Act*, s. 118.1(1) (total gifts).

[30] *Income Tax Act*, s. 118.1(5).

[31] *Income Tax Act*, s. 118.1(3). After 2001, these rates are indexed according to the formula contained in section 117.1 of the *Income Tax Act*. All calculations in this *Guide* will use the unadjusted rates set out in section 117(2) of the Act.

[32] *Income Tax Act*, R.S.B.C. 1996, c. 215, s.4.4.

The amount of gifts over $200 gives rise to a tax credit at the highest marginal rate even though the taxpayer may not be taxed at the highest rate.

Corporations are entitled to deduct their charitable donations and ecological gifts. They do not receive a tax credit. The same limitations and carry over provisions that apply to individuals apply to corporations.

Example: Martha has a net income of $50,000 per year. She receives an inheritance of $50,000 and donates the entire amount in cash to Western Conservancy Association to assist in their campaign to purchase an island and protect the many rare plant species on the island.

Martha receives a tax receipt for $50,000. In the year of the donation, she may use up to 75% of her income of $50,000, that is, up to $37,500, as the basis for calculating a tax credit for that year. If she claims the maximum tax credit for the year, the federal credit would be (16% x $200) + (29% x $37,300) = $10,849.[33] This would be the amount of the federal tax credit. This amount would be subtracted from the amount of federal tax otherwise payable on her income of $50,000. The balance of the amount of the donation, $12,500, could be carried forward for up to five years.

Martha could claim a tax credit for as little or as much of the donation or portion of the donation remaining, up to 75% of her net income, each year for five years following the donation. The tax credits are non-refundable. If she does not, or cannot because of the amount of her income, use the whole amount of the donation within the five-year period, she will lose the benefit of the remaining portion.

TYPES OF GIFTS

Gifts may be present or deferred.[34] Present gifts are those from which the recipient may receive an immediate benefit. Deferred gifts are gifts that cannot be revoked and from which the recipient will not derive a benefit until some time after the gift is given. A gift of a remainder or residual interest in property — for example, where the right to occupy and enjoy the land arises in the future, after the death of the current occupant — and a gift of both the ownership and benefit of an insurance policy, are examples of deferred gifts.[35] Both present and deferred gifts give rise to tax consequences in the year the gift is made.

[33] It is unlikely that Martha would claim the maximum tax credit in the year of the gift because of other tax credits and benefits available to her.

[34] This section is derived in part from Susan Mehinagic, "Taxation and charities," prepared for a conference held by Pacific Business & Law Institute, in Vancouver, BC, February 18, 1998, at pp. 1.19-1.25.

[35] See the section below headed "Gift Planning" for a more detailed discussion of deferred gifts.

Deferred gifts are treated in a similar way to present gifts. They are dealt with in the year the gift is made. There are differences, however, in the way the value of present and deferred gifts is determined.[36]

The tax treatment of a gift also depends on the nature of the gift. A gift may be

- cash or
- other property such as
- land,
- interests in land, such as conservation covenants,
- life insurance,
- an equitable interest in a trust,
- listed securities; and
- listed personal property such as art or jewellery, and other personal-use property.

The *Income Tax Act* also contains specific provisions for certain kinds of gifts of land and personal property. For example, there is a specific category for gifts of ecologically sensitive land and certified cultural property. In addition, dispositions of principal residences and qualified farm property may benefit from tax exemptions under the *Income Tax Act*.

Some of these types of gifts will be discussed in greater detail below.

INCOME INCLUSION OR CAPITAL GAIN

Gifts, other than cash gifts, may give rise to the inclusion of an amount in the taxpayer's income or to a capital gain. The property must be valued at the time of the gift and any gain in the value of the property from the time it was acquired generally must be taken into account in calculating the donor's income for the year. The donor must account for the gain even though the donor does not actually receive any money or other consideration.

Depending on the circumstances, property may be either capital property, inventory of a business, or an adventure in the nature of trade. For example, if a donor of land buys and sells land as part of its business, the land may be inventory of the business. This might occur if a real estate developer makes a charitable donation of land acquired in the course of its business. In these circumstances, any gain in the value of the land at the time of the transfer would be included in the taxpayer's income for the year. In other circumstances, the land would be capital property and any gain in the value of the land at the time of the gift would be treated as a capital gain. As discussed below, the tax rate applicable to capital gains is less than that applicable to other types of income.

[36] A present value must be determined for gifts that are deferred until a later date. See the section below headed "Gifts of an interest in a trust" for a more in depth discussion of determining present value. See also the section below headed "Valuation of land" for a discussion of the valuation of gifts of land.

TAX TREATMENT OF CAPITAL PROPERTY

Capital property is generally property in relation to which a gain or loss on disposition would be a capital gain or loss.[37] The property might be land or any other kind of property. Property that is inventory of a business is not capital property. One hundred percent of any gain or profit on the disposition of the inventory of a business is included in the taxpayer's income. In many cases, however, dispositions of land or partial interests in land for conservation purposes will be dispositions of capital property.

Gifts, the death of a taxpayer and the change in use of property result in dispositions for tax purposes. Therefore a gift of capital property may give rise to a capital gain if the property has appreciated in value since the time the taxpayer acquired the property. The gift could also result in a loss. If the property is depreciable property and has depreciated, a terminal loss or recaptured depreciation may arise. It is important to remember, however, that the gift will also result in a tax credit or deduction that will offset the amount of tax on the gain. In addition, there may be exemptions available depending on the kind of property disposed of by the taxpayer.

The death of a taxpayer will bring into the taxpayer's income for the year a portion of any gain in value of the taxpayer's capital property unless the beneficiary of the property is the taxpayer's spouse.

CALCULATION OF GAINS AND LOSSES

Capital gains

Simply speaking, the amount of a gain on the disposition of capital property is determined by subtracting the cost of the property to the taxpayer and the costs related to disposing of the property from the value of the property at the time of disposition.[38] The original cost of the property or Valuation Day value, with specified adjustments permitted by the *Income Tax Act*,[39] is called the adjusted cost base. It is the cost of the property for the purpose of calculating whether or not there has been a capital gain.

The entire gain is dealt with in the year of disposition. Generally 50% of the gain will be included in the taxpayer's income for the year. The remaining 50% of the gain is not taxed.[40]

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[37] *Income Tax Act*, s. 54 (capital property).

[38] The taxation of capital gains is effective from the beginning of 1972. Any taxpayers holding capital property that they acquired before the end of 1971 should value their property as of Valuation Day. Valuation Day for most property is December 31, 1971. Valuation Day for publicly traded shares and securities is December 22, 1971. Consult your tax advisor.

[39] *Income Tax Act*, s. 53.

[40] *Income Tax Act*, s. 38.

Example: Sandra sells publicly traded shares for $15,000. The costs associated with selling the shares are $100. She purchased the shares for $8,000 and paid a commission of $150 when she purchased them. The amount of Sandra's capital gain is $6,750.[41]

Proceeds of disposition		$ 15,000
minus adjusted cost base	$8,000 + $150	$ 8,150
minus selling costs ($100)	$100	$ 100
Equals capital gain		**$ 6,750**

$3,375 or 50% of the gain of $6,750 will be included in Sandra's income for the year.

Capital losses

A capital loss[42] is a loss arising on the disposition of capital property and certain other specified kinds of property. A disposition of property in an income-earning transaction, such as the sale of inventory, does not give rise to a capital loss. Nor does the disposition of personal-use property.[43]

A loss is generally the excess of the adjusted cost base of the capital property over the proceeds of disposition of the property less the costs of selling the property. Capital losses may be carried back three years and forward indefinitely.

The deductible portion of the capital loss (the allowable capital loss) may be offset against taxable capital gains. The deductible portion of a capital loss is 50%.

[41] As with all examples in this *Guide*, this example is simplified. The tax consequences of a sale of shares may be more complex.

[42] See *Income Tax Act*, ss. 39(1), 111.

[43] Personal-use property is defined in section 54 of the *Income Tax Act* to include property of a taxpayer used primarily for the taxpayer's personal use and enjoyment.

GIFTS OF CAPITAL PROPERTY

Gifts of capital property, including land and interests in land, are dispositions of the property and could give rise to a capital gain. However, the gift also results in a tax credit or deduction that can be used to offset the tax on the gain.

If a donor makes a gift to a qualified recipient or makes an ecological gift, the donor may designate any amount between the adjusted cost base and fair market value of the property (if the property has increased in value) to be the value of the gift. This amount is deemed to be both the proceeds of disposition of the property and the amount of the donation.

If the donor makes the gift of capital property to the Crown, a municipality, a registered charity or one of the other qualified recipients, or makes an ecological gift, the donor may designate any amount between the adjusted cost base and fair market value of the property (if the property has increased in value) to be the value of the gift. The designated amount is deemed to be the proceeds of disposition of the property and the gain is calculated on the basis of this amount. The designated amount is also deemed to be the amount of the donation.[44]

If the taxpayer elects the adjusted cost base as the proceeds of disposition, there will be no gain. If the property has appreciated in value and the taxpayer elects an amount that results in a gain, 50% of the gain will be included in the taxpayer's income. However, the taxpayer is eligible for a tax credit for the gift calculated as a percentage of the total of

- up to 75% of the taxpayer's income for the year, plus
- 25% of the taxable capital gain, plus
- 25% of recaptured capital cost allowance.[45]

Capital cost allowance is based on the cost of acquiring the property against which it is claimed. It may be claimed only on depreciable property as defined in the *Income Tax Act* and is claimed at a rate prescribed in the tax legislation. In effect, it is a prescribed rate of depreciation in the value of property. It may only be claimed in relation to depreciable property that is acquired for the purpose of producing income.

Capital cost allowance is deducted from income from a business or property. It allocates the cost of assets over the useful life of the asset. However, when the asset is disposed of, some or all of the capital cost allowance deducted over the years may be recaptured depending on the sale price or fair market value of the asset at the time of disposition.

Land is not depreciable property. However, buildings or other property located on land might be depreciable property, but only if the land and buildings have been used to earn income.

[44] *Income Tax Act*, ss. 118.1(6), 110.1(3).

[45] *Income Tax Act*, ss. 118.1(1) (total gifts). Consult your tax advisor for information about capital cost allowance and the tax treatment of depreciable property.

Example: Scenario 1

Robert bought a small tractor for $10,000 for use on his farm. After several years of owning the tractor, he gives the tractor to Western Conservancy Association, a registered charity. This is the only donation Robert makes in the year. Because the tractor is depreciable property that was used in his farming business, Robert claimed capital cost allowance of $7,000 over the years of owning the tractor. The value of the tractor at the time of the gift is $4,000.

Since Robert claimed a total of $7,000 in capital cost allowance over the years, and the tractor depreciated in value by only $6,000, he must include or "recapture" $1,000 of capital cost allowance previously claimed in his income for the year.

Robert had other income in the year of $45,000. Including the $1,000 recaptured capital cost allowance brings his net income to $46,000. He received a tax receipt for $4,000, the amount of the gift. He can claim a tax credit based on the entire $4,000 since it is less than 75% of his income.

Scenario 2

If, on the other hand, the fair market value of the tractor at the time of the gift were greater than the original cost, Robert would have to include all the capital cost allowance claimed, that is, $7,000, in his income. Assume the value of the tractor at the time of the gift is $12,000. Robert must include the capital cost allowance he claimed, $7,000, in his income for the year. He will also have a capital gain of $2,000. $1,000 or 50% of the gain will be included in his income. The gift will therefore result in additional income of $8,000 for the year.

However, Robert can offset the amount of the tax on the additional income by a tax credit. Robert will receive a tax receipt for $12,000. He has a net income for the year of $53,000. If he wishes, he can claim a tax credit in the year calculated against the entire $12,000 (because it is less than 75% of his net income). Alternatively, Robert can carry forward any or all of the $12,000 for up to five years.

Example: Fiona inherited land in 1996 that was valued at $150,000 at the time she received title to the land. She wants to conserve the land in its natural state and in 2003 gives the land to Western Conservancy Association. The gift is not an ecological gift. At the time of the gift, the land has a fair market value of $200,000. Fiona designates the fair market value of the land as the value of the gift. This amount is also the proceeds of disposition. She receives a tax receipt from Western Conservancy Association for $200,000.

Fiona's adjusted cost base is $150,000. The gift therefore results in a capital gain to Fiona of $50,000 (proceeds of disposition of $200,000 minus adjusted cost base of $150,000). The taxable portion of the capital gain is 50% of $50,000 or $25,000. Fiona's other income for the year is $40,000. The amount of the gain is included in Fiona's income for the year bringing her total net income to $65,000.

Fiona is eligible for a tax credit against her 2003 federal tax based on the following calculation:[46]		
75 % of net income	0.75 x $65,000	$ 48,750
Add: 25% of taxable capital gain	0.25 x $25,000	$ 6,250
Tax credit may be calculated on up to		$ 55,000
Possible tax credit for the year		
16% of first $200	0.16 x $200	$ 32
Add: 29% of remainder	0.29 x $54,800	$ 15,892
Total tax credit		**$ 15,924**

If Fiona takes the full tax credit available for the year, she can carry the balance of the donation ($200,000 – $55,000 = $145,000) forward for up to five years. If her income is not high enough in the next five years to use the balance of the donation to claim a tax credit, she will lose the remaining benefit.

For more information about gifts for the purposes of the *Income Tax Act* see ***Gifts and Income Tax***, P113; ***Gifts and Official Donation Receipts***, IT-110R3; ***Gifts of Capital Properties to a Charity and Others***, IT-288R2; and ***Gifts to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust***, IT-226R available on the CRA website at http://www.ccra-adrc.gc.ca/

[46] After 2001, the tax brackets are indexed according to the formula contained in section 117.1 of the *Income Tax Act*. All calculations in this *Guide* use the unadjusted rates set out in section 117(2) of the Act.

CAPITAL GAINS EXEMPTIONS

Principal residence exemption

Generally, the entire amount of a capital gain on the disposition of a principal residence is exempt from tax.[47] This exemption is unlimited. To qualify as a principal residence, the residence must be "a housing unit, a leasehold interest in a housing unit or a share of the capital stock of a co-operative housing corporation acquired for the sole purpose of acquiring the right to inhabit a housing unit owned by the corporation" that is owned and ordinarily inhabited in the year by the taxpayer, the taxpayer's spouse or a child of the taxpayer.[48]

A taxpayer must designate a residence as his or her principal residence and only one residence can be designated as the taxpayer's principal residence in any one year. A full tax exemption may not be available for principal residences located on more than half a hectare of land. The definition of "principal residence" generally limits the amount of land on which the exemption may be claimed to one contiguous half-hectare unless the taxpayer can show that more of the land is necessary to the taxpayer's use and enjoyment of the residence as a residence. Consequently, if a taxpayer's principal residence is located on four hectares of land and the taxpayer disposes of the principal residence, any gain in the value of the land over and above the one half-hectare may be a capital gain, part of which must be taken into income.

Example: Simon gives his principal residence located on four hectares of land to Western Conservancy Association. He purchased the property for $125,000. The fair market value of the property at the time of the gift is $200,000. He had the property appraised and the appraiser allocated 80% of the value of the property to the principal residence and half-hectare of property.

There is a total capital gain of $75,000 at the time of the gift (fair market value of $200,000 – adjusted cost base of $125,000). 80% of the gain ($60,000), the amount attributable to the principal residence, is not included in Simon's income and is non-taxable. 20% of the gain ($15,000), the amount attributable to the additional 3½ hectares, is not tax-exempt. 50% of the $15,000 ($7,500) is included in Simon's income for the year.

Simon receives a tax receipt for $200,000 and can claim a tax credit based on up to 75% of his income in the year of the gift plus 25% of his taxable capital gain of $7,500. He can carry forward any unclaimed portion of his donation for five years.

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[47] *Income Tax Act*, s. 40(2)(b).

[48] *Income Tax Act*, s. 54 (principal residence). The definition is detailed and the requirements differ depending on the nature of the taxpayer. See section 54 for the details of what qualifies as a principal residence.

"Lifetime" capital gains exemption

Prior to 1994, up to $100,000 in capital gains on the disposition of any capital property was exempt from tax in each taxpayer's lifetime. In 1994, the government eliminated this exemption and provided that taxpayers could elect, as of February 22, 1994, to take any gains accrued to that point on capital property not yet disposed of by the taxpayer. This allowed taxpayers to take advantage of the $100,000 exemption before it was eliminated and resulted in an increased cost base for any assets for which a taxpayer made the election.

Anyone who made an election as of February 22, 1994, should remember to add the elected amount to the cost of the property when calculating any gains or losses on a subsequent disposition of the property.

While the $100,000 general capital gains exemption has been eliminated, certain other capital gains exemptions continue to be available, including exemptions for dispositions of qualified farm property or shares of a qualified small business corporation. However, there is a maximum lifetime capital gains exemption for individuals of $500,000. The $500,000 includes any exemptions claimed under the previous $100,000 exemption and may apply to the disposition of qualified farm property or shares of a qualified small business corporation. Thus, if a taxpayer has used the $100,000 exemption, there is only a $400,000 exemption remaining. The lifetime capital gains exemption does not relate to the principal residence exemption.

Though the application of the $500,000 capital gains exemption may be used to shelter up to $500,000 of capital gains from certain property from income tax, individuals relying on this exemption should obtain professional advice as unforeseen consequences such as liability for alternative minimum tax or clawback of old age security or child tax benefit reduction may result in years when taxpayers avail themselves of these exemptions.

Qualified farm property exemption

The disposition of qualified farm property may give rise to the opportunity to shelter the capital gain with a capital gains exemption.[49] Qualified farm property includes real property used by the taxpayer or a member of the taxpayer's family to carry on the business of farming, certain shares of a family farm corporation, an interest in a family farm partnership and certain eligible capital property.

Two distinct rules apply to the qualification of farm property depending on whether the property was acquired before or after June 18, 1987. In addition, the tax rules pertaining to qualified farm properties are quite complex. Professional advice therefore should be sought to determine which rule applies and how the rules apply.

For example, for property acquired after June 17, 1987, to qualify, among other things, it must have been owned by the taxpayer throughout the 24 months prior to its disposition. In addition, in at least two years in which the taxpayer owned the property, the gross revenue from the farming activities must have exceeded the taxpayer's income from all

[49] *Income Tax Act*, ss. 110.6(1) (qualified farm property), 110.6(2).

other sources.[50] Any gains up to the lifetime maximum of $500,000 realized on the disposition of qualified farm property are exempt from income tax. However, alternative minimum tax may apply.[51]

In the example above, if Simon's property were a qualified farm property, it would be eligible for this exemption. There would be a capital gain, 50% of which Simon would have to include in calculating his net income for the year. However, because of the qualified farm property exemption, Simon could deduct the amount of the taxable gain in calculating his taxable income assuming he had not already claimed the total lifetime exemption of $500,000. In other words, the gain would not be taxable. He could still claim a tax credit based on up to 75% of his net income.

Small business shares exemption

A similar exemption of up to $500,000 is available in relation to gains on the disposition of shares of a qualified small business corporation.[52] Generally speaking, a qualified small business corporation is a Canadian-controlled private corporation substantially all of the assets of which are used in an active business carried on primarily in Canada. At the date of disposition of the shares, all or substantially all of the fair market value of the assets must relate to assets used in an active business carried on in Canada. For the twenty-four months preceding the disposition, 50% of the fair market value of the assets must have been used in an active business carried on primarily in Canada. The taxpayer or persons related to the taxpayer must have been the only person to own the shares in the 24 months preceding the disposition of the shares.

Assuming there is some portion of the allowable $500,000 exemption remaining, a gift of shares of a qualified small business corporation would be eligible for the exemption.

[50] A different test may apply for those who acquired the property prior to June 18, 1987.

[51] See the section "Possible adverse consequences" for a brief explanation of alternative minimum tax.

[52] *Income Tax Act*, ss. 110.6(1) (qualified small business corporation share), 110.6(2.1).

GIFTS OF LAND AND INTERESTS IN LAND

Donors may wish to give land or an interest in land to conserve and protect the important ecological values of the land. As discussed above, land generally is either capital property or inventory of a business. Each of these is treated differently.

GIFTS OF LAND THAT IS CAPITAL PROPERTY

Taxpayers who give land[53] or an interest in land that is capital property may have a capital gain in the year of the gift and also may be eligible for a tax credit or deduction. To qualify for a tax credit or deduction, the land must be given to a recipient qualified under the *Income Tax Act* to receive charitable gifts. A gift of land may consist of

- a gift of the land itself so that title to the land is transferred to the recipient of the gift, or
- a gift of an interest in the land such as
- an easement,
- a covenant, or
- a remainder or residual interest in land.

An easement is a right of use, generally a right of passage over another's land. An easement might prevent the owner of the land subject to the easement from doing certain things specified in the easement document. It also might require the landowner to do certain things. At the same time, the easement provides a benefit to the owner of adjacent or nearby land, for example by allowing that owner to pass over the land against which the easement is registered.

A covenant is a written document in which those signing the covenant commit to do or not do certain things or agree on a certain set of facts. Generally, a covenant contains promises by a landowner in relation to uses of the land limiting or prescribing the uses to which the land will be put. Covenants are frequently used to control the use of property or to preserve it.

A remainder or residual interest in land is a right to enjoy or own the land in the future. It is the interest left over after property was used and enjoyed first by another person for his or her lifetime or for a specified period of time.[54] A gift of a remainder or residual interest in land is a deferred gift and a present value for the gift must be calculated.

Gifts of title to land or other interests in land are subject to the general considerations outlined above respecting gifts and are eligible for a tax credit based on up to 75% of the taxpayer's income. If the land is capital property, the limit against which a tax credit may

[53] In this *Guide*, land includes buildings on the land unless the context indicates otherwise.

[54] See the chapter headed "Gift Planning" for a more detailed discussion of remainder interests in land.

be claimed will be increased by 25% of any taxable capital gain and 25% of any recaptured capital cost allowance paid on any depreciable property, including buildings, located on the land.[55]

Although this formula is clear, determining both the original cost and the value of a covenant at the time of its disposition may present difficulties. These difficulties are discussed below.

Example: Frances has owned a piece of vacant land since 1996. She gives the vacant land to Western Conservancy Association to preserve the natural values of the land, but does not make an ecological gift of the land. Frances bought the land for $75,000. This is also her adjusted cost base for the land.[56] At the time of the gift, the land is appraised at $125,000. Frances designates this as the value of the gift. The proceeds of disposition are therefore $125,000. Frances has a net income of $45,000 for the year before the gift.

There is a deemed capital gain of $50,000 from the gift. 50% of the gain, or $25,000, is taxable and is added to her net income for the year. Her total net income for the year is $70,000.

Frances receives a tax receipt from Western Conservancy Association for $125,000, the full value of the land. The limit of her income against which she can claim a tax credit is $58,750:

75% of net income of $70,000	0.75 x $70,000	$52,500
Add: 25% of taxable capital gain of $25,000	0.25 x $25,000	$ 6,250
Federal tax credit calculated as percentage of		$ 58,750
16% of first $200	0.16 x $200	$ 32
Add: 29% of balance	0.29 x $58,550	$ 16,980
Federal tax credit		**$ 17,012**

If Frances is able to and chooses, she can claim the maximum tax credit and carry forward $66,250, the balance of the donation, for five years.[57] The tax benefit from

[55] Recall that depreciable property is property of a prescribed class that is used to produce income. Where land and the buildings located on the land have not been used to produce income, the property will not be depreciable property. No capital cost allowance will have been deducted and there will be no recapture or deemed recapture on disposition of the property.

[56] In fact, a number of factors other than the original cost must be taken into account to determine the adjusted cost base of capital property.

[57] It is unlikely that Frances would claim the maximum tax credit available to her in the year of the gift because of the other tax credits and other benefits that would be available to her.

the donation will offset the taxable capital gain and provide a significant additional credit against federal tax otherwise payable.

Alternatively, Frances may choose to claim a lower tax credit in the year of the gift and spread the benefit of the donation over the next five years.

GIFTS OF INVENTORY LAND

Gifts of inventory lands do not attract the same tax benefits as gifts of capital property. A donor of inventory lands must include the fair market value of the land donated in its income for the year. The donor may deduct from income the cost of the land and any other allowable costs capitalized relevant to the land, which may include financing costs, costs related to acquiring the land, ongoing maintenance costs and other allowable costs. All the profit derived from the disposition of inventory lands (selling price less cost of the land and other allowable costs) must be included in the taxpayer's income for the year. In the case of capital property on which there is a capital gain, however, only 50% of a capital gain must be included in income. (As discussed below, for ecological gifts, the inclusion amount is 25% of the capital gain.)

The result is that the tax implications of making a gift of land from inventory are essentially the same as those of making a cash donation. The *Income Tax Act* does not currently offer any tax incentives for businesses to donate inventory property such as land rather than cash.

Examples

Delightful Developments Ltd. donated 30 acres of land to Western Conservancy Association. The land was part of a larger parcel Delightful bought with the intention of subdividing it into five acre parcels. Delightful's costs attributable to the 30 acres were $100,000. At the time of the gift, the fair market value of the land was $250,000. The land is considered inventory of Delightful's business. Delightful has other income of $800,000 from land sales for the year and other costs of $600,000.[58]

Example 1

Sales of land	800,000
Value of land donated	250,000
Gross income	1,050,000
Less costs (including $100,000 costs associated with donated land)	700,000
Net income	350,000
Less deduction for donated land	250,000
Taxable income	100,000

[58] This example is simplified for illustration purposes and does not take into account expenses, such as financing and acquisition costs, that Delightful could deduct from the fair market value in calculating its profit.

Example 2

Instead of donating it, Delightful sells the land for fair market value and makes a cash donation of $250,000 to the conservation organization.

Sales of land (and gross income)	$1,050,000
Less costs as above	700,000
Net income	350,000
Less deduction for cash donation	250,000
Taxable income	100,000

Example 3

Delightful donates land of the same value which is capital property not inventory. The adjusted cost base of the land is $100,000. The capital gain would be $150,000 (fair market value of $250,000 less adjusted cost base of $100,000). Delightful must include 50% of the gain in income.

Sales of land	$ 800,000
Taxable capital gain (50% of $150,000)	75,000
Gross income	875,000
Less costs	600,000
Net income	275,000
Less deduction for donated land	225,000[59]
Taxable income	50,000

As the examples show, the tax incentives are greater for gifts of capital property than for gifts of inventory.

ECOLOGICAL GIFTS

An ecological gift is a gift of ecologically sensitive land that meets certain criteria in the *Income Tax Act*.[60] The gift may be an outright gift of the land itself so that title to the land passes from the giver to the receiver. Alternatively, the gift may take the form of a covenant, easement or servitude.[61]

To qualify for a tax credit or deduction, the gift must be

- a gift of land (including a covenant, easement or servitude) certified by the federal Minister of the Environment (or a person designated by the Minister) to be ecologically sensitive land, the conservation and protection of which is, in the opinion of the Minister or designate, important to the preservation of Canada's environmental heritage; and
- made to

[59] 75% of net income plus 25% of taxable capital gains.

[60] For more information about the Ecological Gift Program, go to the Program's website at http://www.cws-scf.ec.gc.ca/ecogifts/ . In particular, see the Canadian Ecological Gifts Program Handbook at http://www.cws-scf.ec.gc.ca/ecogifts/hb_toc_e.cfm and, for additional examples, the tax scenarios on the Program's website.

[61] In Quebec law, a servitude is a right to use another's land. It is a burden on the land requiring the owner to permit access to the beneficiary of the servitude.

- Canada,
- a province or territory of Canada,
- a municipality in Canada; or
- a registered charity, one of the main purposes of which is, in the opinion of the Minister or designate, the conservation and protection of Canada's environmental heritage, and which is approved by the Minister or designate as an acceptable recipient of the gift.

In addition, the fair market value of the ecological gift must be certified by the Minister of the Environment.

If the gift meets the above criteria, a tax credit or deduction may be claimed based on the full fair market value of the property or the value of the covenant, easement or servitude. Tax credits claimed in respect of ecological gifts are not subject to the 75% income limitation. The full value of the gift may be used to calculate the tax credit limited only by the extent to which the donor's income will allow the credit to be used. This is one advantage of ecological gifts over other gifts of land.

In addition, ecological gifts of capital property benefit from a reduced capital gains inclusion rate. Only 25% of a capital gain deemed to arise on a gift of capital property must by included in the donor's income for the year if the gift is an ecological gift. As we have seen, for other gifts of capital property, 50% of the gain must be included.

Another potential advantage of ecological gifts arises from the certification process described below. The certification process and the tax that can be imposed by CRA on an unauthorized disposition or change of use of land given as an ecological gift may provide additional security to the donor that the gift will be used for the purpose for which it was intended.

However, because both the land itself and the value of the ecological gift must be certified, the process of donating has additional requirements which may add to the time involved in making the gift. Those contemplating giving an ecological gift should explore the extent to which they will be able to benefit from the advantages with their tax and legal advisors.

Ecological gifts generally will be gifts of capital property and may give rise to a capital gain. However, any such gain would be offset by the availability of a tax credit calculated against up to 100% of the taxpayer's income. As with other gifts, any portion not claimed in the year of the gift may be carried forward and deducted to the extent chosen by the individual for five years following the gift.

Gifts of inventory land qualify as ecological gifts. However, as explained above, the tax benefits associated with gifts of inventory land are not as great as with gifts of land that is capital property. The full value of the land less costs and expenses associated with it must be taken into the taxpayer's income for the year while, in the case of capital property, only 25% of any capital gain will be included. The other benefits associated with ecological gifts apply.

To date, over 280 ecogifts valued at over $64 million have been donated across Canada, protecting nearly 22,000 hectares of wildlife habitat. More than one-third of these ecogifts contain areas designated as being of national or provincial significance, and many are home to some of Canada's species at risk.[62]

Process for certifying ecological gifts

In order to qualify as an ecological gift,

- the land that is the subject of the gift must be ecologically sensitive land and certified as such by the Minister of the Environment or a person designated by the Minister;
- the recipient must be qualified to receive the ecological gift; and
- the fair market value of the land that is the subject of the gift must be determined by the Minister.

Certification of land as ecologically sensitive

Environment Canada has developed a general national definition for "ecologically sensitive land." Ecologically sensitive land includes:

- areas identified, designated, or protected by a local, provincial, territorial, national, or international system or body as ecologically significant or important;
- natural spaces of significance to the environment in which they are located;
- areas that have significant current, or potential for, enhanced ecological values as a result of their geographic proximity to other significant properties;
- areas, whether urban or rural, that are zoned for conservation purposes such as "green space" but excluding those zoned for such exclusive land uses as agricultural production;
- natural buffers around environmentally sensitive areas such as water bodies, beaches, streams, or wetlands; and
- areas that contribute to the maintenance of biodiversity or Canada's environmental heritage.[63]

At the time of writing, Ontario, Quebec, Prince Edward Island and New Brunswick also had developed expanded provincial criteria for identifying ecologically sensitive land.[64]

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[62] Ecological Gift Program website at http://www.cws-scf.ec.gc.ca/ecogifts/history_e.cfm . Page updated June 20, 2003.

[63] Ecological Gifts Program website at http://www.cws-scf.ec.gc.ca/ecogifts/eco_e.cfm#nec .

[64] Ecological Gifts Program website at http://www.cws-scf.ec.gc.ca/ecogifts/eco_e.cfm#nec . The provincial criteria can be found here.

Other criteria

There are a number of other criteria for determining what lands qualify as ecological gifts. For example, land must be privately owned for the gift to qualify as an ecological gift. Donations of leased Crown land do not qualify.

If ecologically sensitive land is contained within a larger parcel of land and the entire parcel is donated, the entire donated property qualifies as an ecological gift.

Only full transfers of title and transfers of covenants, easements and servitudes established through common law or legislation qualify.[65] For example, a transfer of an interest in a trust that held ecologically sensitive land would not qualify as an ecological gift.

Designated certification authorities in British Columbia

To qualify as an ecological gift, land must be certified as ecologically sensitive by the federal Minister of the Environment or designate.[66] The Minister of the Environment has designated six Environment Canada senior managers to act as federal certifying authorities. One of these is the Regional Director, Pacific and Yukon Region, for Environmental Conservation.

In addition, provincial authorities are sometimes designated through federal-provincial agreements or other administrative arrangements. As well, some non-government conservancy organizations have been granted the ability to "self certify" land they will receive as ecologically sensitive.

To get an up to date list of the authorities currently designated in British Columbia, contact the regional coordinator of the Ecological Gifts Program.

Certification authorities

- certify the character of the ecological gift on the required Certification for Donation of Ecologically Sensitive Land form issued by Environment Canada; and
- in the case of registered charities, approve the recipient to receive the gift.

Qualified recipients of ecological gifts

The federal or any provincial Crown and its agencies are qualified to receive ecological gifts as are Canadian municipalities. The list of non-governmental organizations that have been approved to receive ecological gifts exceeded 135 as of June 20, 2003 and may be found at http://www.cws-scf.ec.gc.ca/ecogifts/recip_e.cfm

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[65] As discussed previously, legislation in place in British Columbia allows for the establishment of conservation covenants. Other provinces have similar legislation.

[66] *Income Tax Act*, s. 110.1((1)(d); s. 118.1(1), definition of "total ecological gifts".

Determination of fair market value

The tax benefits associated with ecological gifts are based on the fair market value of the land or covenant donated as determined and certified by the Minister of the Environment.[67] To take advantage of the tax benefits, donors must have the value of the land or conservation covenant appraised[68] and submit an *Application for Appraisal Review and Determination* of fair market value together with the appraisal report to the nearest regional office of Environment Canada. The value of the gift will be reviewed by the Appraisal Review Panel which will recommend that the Minister determine the value of the gift to be either that contained in the appraisal report or another value.

If the Minister determines that the fair market value of the gift is a value other than that contained in the appraisal report, the donor may

- withdraw the application,
- accept the value as determined by the Minister, or
- seek a redetermination by the Minister of the fair market value.

If the donor seeks a redetermination, the original determination will be reviewed by the Redetermination Committee of the Appraisal Review Panel which, again, will recommend a fair market value to the Minister. After the Minister's redetermination of the value of the gift, the donor may withdraw the application or accept the value set by the redetermination.

If the donor accepts the fair market value as determined or redetermined by the Minister, upon receiving evidence, such as a registered transfer document, that the ecological gift has been made, the Minister will issue a *Statement of Fair Market Value of an Ecological Gift* at the value as determined or redetermined by the Minister. The recipient of the gift will then issue a tax receipt to the donor for the amount set out in the *Statement of Fair Market Value of an Ecological Gift*.

The value determined or redetermined by the Minister will apply to the land or covenant for all income tax purposes related to charitable donations and gifts for a period of two years from the date of the determination or redetermination.[69]

The donor has the right to appeal the redetermination of value by the Minister to the Tax Court of Canada.[70]

The donor may request a determination of fair market value of an ecological gift either before making the gift or after making the gift, provided the request is made no later than three years after the end of the donor's tax year in which the gift was made.

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[67] *Income Tax Act*, s. 110.1((1)(d); s. 118.1(1), definition of "total ecological gifts". See also sections 118.1(10.1) – (12).

[68] See the discussion below on valuation of land and interests in land.

[69] *Income Tax Act*, s. 118.1(10.1).

[70] *Income Tax Act*, s. 169(1.1).

Summary of process for donating an ecological gift

- Have the value of the land or the interest in the land appraised.
- Choose the recipient and ensure the recipient is qualified to receive ecological gifts.
- Obtain the Certificate for Donation of Ecologically Sensitive Land from the appropriate certification authority.
- Obtain the Determination of Fair Market Value of an Ecological Gift from the Minister of the Environment.
- Make the gift, if it has not already been made.
- Obtain a Statement of Fair Market Value of an Ecological Gift from the Minister of the Environment.
- Obtain a tax receipt from the recipient for the fair market value of the land or covenant based on the amount in the *Statement of Fair Market Value of an Ecological Gift*.
- Include the Certificate for Donation of Ecologically Sensitive Land, Statement of Fair Market Value of an Ecological Gift and the tax receipt with the tax return for the year.

Unauthorized Disposition or Change of Use Tax

A tax will be imposed if a municipality or charity that is the recipient of an ecological gift disposes of it or changes its use without the authorization of the Minister of the Environment or the Minister's designate.[71] The amount of the tax is 50% of the fair market value of the property at the time of the unauthorized disposition or change in use.

This is a significant penalty and provides additional security that land certified as an ecological gift will be protected as intended by the donor.

Even where proposed changes appear to be consistent with the purposes of the gift, recipients of ecological gifts must review any proposed dispositions or changes to the use of donated land, easements or covenants with a designated certification authority prior to the change. Failure to do so may result in the imposition of the tax.

CALCULATING ORIGINAL COST OF A CONSERVATION COVENANT

General gifts

To determine whether there has been a gain or loss in the value of capital property, it is necessary to determine its adjusted cost base. The adjusted cost base of land is the original cost adjusted as permitted by the *Income Tax Act*.[72] However, determining the original cost of a conservation covenant placed on land after the acquisition of the land can be challenging. While the original cost of the land itself is generally easily determined (the

[71] *Income Tax Act*, s. 207.31.

[72] *Income Tax Act*, s. 53. The adjustments will include additional costs of purchasing the property, such as legal fees.

purchase price for the land), this is not true of a covenant which is only a portion of the bundle of legal rights attached to the land.

Since there is no original purchase price for the covenant itself, there is no amount that can be clearly allocated to it. Furthermore, it is difficult to determine after the fact what the covenant would have been worth at the time the land was purchased, particularly if some time has passed since the purchase of the land.

In recognition of this difficulty, the *Income Tax Act* provides that where only part of a capital property is disposed of, the gain or loss on disposition is calculated by attributing as much of the adjusted cost base of the entire property to the part being disposed of as is reasonable.[73]

Although CRA has also addressed the problem in an interpretation bulletin, it has provided little guidance as to what is reasonable. CRA has indicated, however, that the cost of an easement or right of way can equal its proceeds of disposition where:

- the portion of the property in respect of which an easement or right of way was granted is not more than twenty percent of the area of the whole property; and
- the proceeds of the compensation received are not more than twenty percent of the amount of the adjusted cost base of the whole property.[74]

CRA offers no such assistance in determining the cost base of interests in land such as covenants, easements and rights of way covering or worth more than twenty percent of the property. Gifts of such interests may well give rise to a capital gain.

Despite the problems inherent in doing so, donors may have to take steps to determine the adjusted cost base of the covenant. There have been reasonable methods proposed for calculating the cost base of covenants[75] and property owners who are contemplating making a gift of a conservation covenant should seek assistance from a qualified appraiser.

In addition to determining the cost of the covenant, it will be necessary to determine its value at the time of disposition in order to calculate the amount of the capital gain (or loss), if any, and fix the value of the gift for the purpose of obtaining a tax receipt. Valuing conservation covenants at the time of disposition also presents challenges.[76] These difficulties will be discussed in the next section.

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[73] *Income Tax Act*, s. 43.

[74] IT-264R.

[75] Ian C. Attridge, ***Conservation Easement Valuation and Taxation in Canada***, Ottawa, ON: North American Wetlands Conservation Council (Canada), 1997, Report No. 97-1, pp. 25-26. In addition, see the discussion below about determining the adjusted cost base of a covenant that qualifies as an ecological gift.

[76] For a more in-depth guide to the valuation of conservation covenants and easements see Ian C. Attridge, ***Conservation Easement Valuation and Taxation in Canada,*** above at footnote 75, and Ann Hillyer and John Miller, ***Appraising Easements***, forthcoming.

Ecological gifts

The *Income Tax Act*[77] addresses the problem of determining the cost base of covenants that qualify as ecological gifts. The Act establishes a formula for determining the portion of the total adjusted cost base of the land that can reasonably be regarded as attributable to the covenant. The formula, which applies to ecological gifts made after February 27, 1995, is:

(A x B) divided by C	where	**A**	is the original adjusted cost base of the land before the covenant
		B	is the value of the covenant[78]
		C	is the fair market value of the land immediately before the covenant was granted.

This cost base would be used to determine whether granting the covenant gives rise to a capital gain or loss. The Act also provides that, for greater certainty, the donor's cost of the land itself is reduced at the time of the gift by the amount determined to be the cost base of the covenant.

For example, a donor purchased land in 1985 for $100,000 and granted a covenant in 2002 that qualified as an ecological gift. The fair market value of the covenant was appraised at $30,000. The value of the land immediately before the covenant was granted was determined to be $200,000. Using the new formula the adjusted cost base of the covenant would be $15,000.

$$\frac{\$100{,}000 \times \$30{,}000}{\$200{,}000} = \$15{,}000$$

Although the Act does not explicitly state that this method can be used for covenants or easements that are not certified as ecological gifts, arguably this formula offers a reasonable approach to determining the adjusted cost base of such interests in land.

[77] *Income Tax Act*, s. 43(2).

[78] See the next section on valuation for a discussion on valuing the covenant.

VALUATION OF LAND

Where a donor does not elect the donor's original cost of donated land as the value of the gift, the basis for obtaining tax benefits from a gift of land or an interest in land is the valuation or appraisal of the land. Income tax and property tax consequences can then be determined on the basis of the appraised value. As noted above, appraising the value of conservation covenants poses challenges not present in appraising the value of the land itself.

BASIS OF APPRAISAL

Land is generally appraised at its fair market value. "Market value" is defined in the Canadian Uniform Standards of Professional Appraisal Practice[79] (the Standards) as

> the most probable price which a property should bring in a competitive and open market as of the specified date under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus.
>
> Implicit in this definition is the consummation of a sale as of the specified date and the passing of title from seller to buyer under conditions whereby:
>
> (1) buyer and seller are typically motivated;
>
> (2) both parties are well informed or well advised, and acting in what they consider their best interests;
>
> (3) a reasonable time is allowed for exposure in the open market;
>
> (4) payment is made in terms of cash in Canadian dollars or in terms of financial arrangements comparable thereto;
>
> (5) the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.[80]

Determining the fair market value involves a consideration of the highest and best use of the land.[81] The Standards define the highest and best use as that reasonably probable and legal use of vacant land or an improved property that is physically possible, appropriately

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[79] Appraisal Institute of Canada, Canadian Uniform Standards of Professional Appraisal Practice (the Standards), Effective 01/01/2004, available at www.aicanada.org/ .

[80] The Standards, above at footnote 79, at p. 47. "), Effective 01/01/2004, available at www.aicanada.org/ .

[81] See Ian C. Attridge, *Conservation Easement Valuation and Taxation in Canada*, above at footnote 75, at p. 10. Also, see Ann Hillyer and John Miller, *Appraising Easements*, forthcoming.

supported, financially feasible, and that results in the highest value.[82] The highest and best use of land may not be its current use.

For example, a taxpayer may wish to retain vacant land in its natural state to preserve ecological values of the land. However, the land might also be suitable for development of a recreational facility or housing. If the highest and best use for the land were for a recreational facility or housing, when the land was donated to a conservancy organization, the land would be valued according to this highest and best use and the tax consequences of the donation calculated on that basis.

The Standards instruct appraisers to identify, among other things, the characteristics of the property and the interest appraised when appraising land. Under the Standards, strengths and weaknesses with respect to characteristics of the property such as any known or apparent title restrictions, easements, encumbrances, leases, reservations, covenants, contracts, judgments, special assessments, liens, or other items of a similar nature, must be analyzed and included in the appraisal report.[83]

THE APPRAISAL PROCESS

The appraisal is an important part of the donation process. Unless the donor designates the value of the gift to be the donor's original cost, the appraisal will establish the value of the gift for both the donor and recipient. The tax consequences of the gift are calculated on the basis of this value. It is important to have evidence of both the original cost of the property and its value at the time of disposition. In the case of a gift, an appraisal report would constitute evidence of the value at the time of the gift.

Although there is nothing in tax legislation stating who is qualified to appraise property, it is important to hire a qualified appraiser.[84] A qualified appraiser's valuation is more likely to be accepted by CRA and to be supportable if CRA challenges the valuation. This provides greater certainty to both the donor and recipient.

The appraiser will generally determine the fair market value of the property by using one of three methods — the direct comparison approach, the cost approach or the income approach. There is also a fourth approach, the subdivision or cost of development approach, which is a blend of the cost and income approaches.[85]

[82] The Standards, above at footnote 79, at p. 57.

[83] The Standards, above at footnote 79, at pp. 12 and 17.

[84] However, appraisers of land donated through the Ecological Gift Program must meet the standards set out in the Ecological Gift Program's Guidelines for Appraisals. A donor of a covenant should consider retaining the services of an appraiser who has experience valuing easements and covenants in the local market.

[85] See Ian C. Attridge, ***Conservation Easement and Valuation Taxation in Canada***, above at footnote 75, pp. 14-19, and Ann Hillyer and John Miller, ***Appraising Easements***, forthcoming, for a more detailed explanation of the different appraisal approaches and their usefulness in valuing conservation covenants.

PROBLEMS APPRAISING CONSERVATION COVENANTS

Although the appraisal methodologies mentioned above apply to appraising the value of conservation covenants, as well as to appraising the land itself, appraising the value of conservation covenants presents certain challenges:[86]

- Conservation covenants and easements are relatively new in Canada and there are relatively few examples of sold or donated conservation covenants or land subject to conservation covenants with which to compare.
- Because the specific provisions of different conservation covenants can vary considerably, the conservation covenants that do exist may not be comparable to the interest being appraised.
- Other, more common kinds of easements and covenants that have different purposes, such as providing access, protecting views or providing rights-of-way for utilities and other services, may not be useful in providing comparable values.
- There is a limited market for conservation covenants because they are usually donated to governments or non-profit organizations. It is therefore difficult to establish a market value, a value determined by agreement between buyer and seller.

As a result of these difficulties, each of the appraisal approaches mentioned above has its limitations with respect to valuing conservation covenants.[87] For example, during 1996, all gifts of covenants, easements or servitudes certified as ecological gifts were deemed by Revenue Canada [now CRA] not to have used acceptable appraisal methods for establishing the fair market value of the interest. Revenue Canada considered the value of the gifts nominal.

The situation has now changed in relation to conservation covenants that qualify as ecological gifts. Since 1997, the *Income Tax Act* has provided that the fair market value of an ecological gift that is a covenant is "the greater of the fair market value otherwise determined of the gift, and the amount by which the fair market value of the land is reduced as a result of the making of the gift."[88] The latter is the before-and-after approach to covenant valuation, discussed below. It applies to gifts made after February 27, 1995, and has been used to claim tax credits retroactively for covenants previously donated.

BEFORE-AND-AFTER APPROACH

The "before-and-after" method of valuation is often used in valuing conservation covenants.

> The before-and-after method is essentially two appraisals in one: it determines the value of the property before a conservation easement is

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[86] Ian C. Attridge, *Conservation Easement Valuation and Taxation in Canada*, above at footnote 75, at pp. 13-14.

[87] It is beyond the scope of this *Guide* to explain in detail appraisal methodologies and their limitations with respect to valuing conservation covenants. Consult an appraiser and refer to Ian C. Attridge, *Conservation Easement Valuation and Taxation in Canada*, above at footnote 75, at pp. 14-19 and Ann Hillyer and John Miller, *Appraising Easements*, forthcoming, for a more in-depth treatment of these issues.

[88] *Income Tax Act*, s. 118.1(12), 110.1(6).

> put in place, and then assesses the value of the property subject to the easement. The difference is then taken to be the value of the easement itself. … The before-and-after method can involve any of the traditional comparable sales, cost, income or subdivision approaches to valuation to determine the before and after values of the property.[89]

Restricting the use of land may devalue the land. In these circumstances, the monetary value of the covenant would be the difference between the monetary value of the land before the covenant is registered and the monetary value after it is registered.

Although the monetary value of land may decrease upon the granting of a covenant, often the effect is minimal and, in some circumstances, placing a conservation covenant on land will increase its value. Any diminution or increase in the value of land on which a covenant has been placed also should be appraised at the time of the gift of a conservation covenant. This increase or decrease in value will be taken into account at the time of the disposition of the larger piece of land.

As discussed above, the before-and-after approach has now been incorporated in the *Income Tax Act* as one method for determining the fair market value of ecological gifts of covenants and easements. It has not been legislatively mandated for easements and covenants that are not treated as ecological gifts.

VALUATION OF ECOLOGICAL GIFTS

As we have seen, valuing conservation covenants can give rise to particular challenges. However, the *Income Tax Act* was amended in 1997 and CRA now accepts tax receipts for ecological gifts of covenants, easements and servitudes for amounts based on the difference between the value of the land before and after the gift.

As discussed above, the *Income Tax Act* specifically provides that, for ecological gifts, the fair market value of the gift of a covenant, easement or servitude to which ecologically sensitive land is subject is

- the greater of
- its fair market value otherwise determined; and
- the amount by which the fair market value of the land is reduced as a result of the making of the gift.[90]

This is also the way in which the value is determined for the purpose of imposing the tax triggered if a recipient transfers or changes the use of the ecological gift of a covenant or easement without authorization.

The *Income Tax Act*[91] provides that

[89] Ian C. Attridge, *Conservation Easement Valuation and Taxation in Canada*, above at footnote 75, p. 19.

[90] *Income Tax Act*, ss. 118.1(12), 110.1(6).

[91] *Income Tax Act*, ss. 110.1(3) and (5) and 118.1(6) and (12).

- the rules that apply in determining the value of an ecological gift would also apply in determining the proceeds of disposition for calculating a capital gain or loss; and
- the donor may report a lesser gain and claim a correspondingly lesser charitable donation tax credit or deduction.[92]

There are no similar provisions relating to gifts of covenants that are not certified as ecological gifts. This specified method for determining the fair market value of an ecological gift therefore may be another advantage of certifying the gift of a conservation covenant as an ecological gift. There may be greater certainty that value will be attributed to the gift and that the donor will receive the tax benefits of the donation.

Timing of the appraisal

The appraisal should occur as soon as possible after someone has begun to seriously contemplate a donation of land or an interest in land. This will allow both the donor and the recipient to evaluate the financial consequences, including the tax consequences, of the gift at an early stage. However, because appraisals take into account the current real estate market, the appraisal should not take place so long before the gift as to render the appraisal inaccurate or unreliable by the time the gift actually takes place.

If the gift is an ecological gift, guidelines established by Environment Canada govern the timing of appraisals.[93] The guidelines state that, in the case of a gift that has not yet been finalized, if the effective date of the appraisal is more than six months before the date the donor submits an *Application for Appraisal Review and Determination* to Environment Canada, the appraiser who completed the appraisal must verify in writing that there has been no material change in the use of the property or to the market in the area of the property. The guidelines also state that if the appraiser cannot verify both of these statements, either a new appraisal must be completed or the appraiser who completed the original appraisal must update the original appraisal.

If a donor has already made the ecological gift, the donor has three years from the end of the taxation year in which the donor made the gift to make a request for a determination of the gift's fair market value.[94] This allows a donor to take advantage of the tax benefits of an ecological gift after the gift has been made.

If the ecological gift has already been made, the effective date of the appraisal must be either no more than six months before the date of the gift, or the date of the gift if the appraisal is completed after the date of the gift.

Again, if the effective date of the appraisal is more than six months before the date of the gift, the appraisal may be used if the appraiser verifies in writing that, between the date of the original appraisal and the date of the gift, there was no material change in the use of the property or the market in the area of the property.

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[92] See the discussion earlier in this Chapter about designating the amount of the proceeds of disposition.

[93] Consult the full Guidelines for Appraisals on the Ecological Gifts Program website at http://www.cws.-scf.ec.gc.ca/ecogifts/process/time_e.cfm .

[94] *Income Tax Act*, s. 118.1(10.3).

OTHER KINDS OF GIFTS

A donor may wish to give gifts of property other than land to organizations whose purpose is conservation and protection of environmentally sensitive land. Donations of almost any kind of property to a qualified recipient will result in a tax receipt.

CASH GIFTS

Cash gifts are the simplest gifts from a tax perspective. Their value is easily determined (the amount of the gift) and they do not give rise to a capital gain or loss. The donor receives a tax credit for the amount of the gift subject to the limitations already discussed. The donor may claim a tax credit based on the value of the cash donation up to a maximum of 75% of the donor's net income for the year.

GIFTS OF SECURITIES

The taxable portion of capital gains deemed to arise on gifts of shares of publicly-traded companies listed on prescribed stock exchanges and shares or units of mutual funds is reduced from 50% to 25%.[95] The donor will be eligible for a tax credit for the fair market value of the shares but will only be required to include in his or her income 25% of any capital gain deemed to arise because of the gift. The limit against which the amount of the donation may be credited remains 75% of the donor's net income plus 25% of the taxable capital gain.

Gifts of other securities not eligible for this special treatment would be treated in the same way as gifts of capital property generally. The donor could claim a tax credit based on the full fair market value of the donated securities up to a maximum in the year of 75% of the donor's net income plus 25% of any capital gain arising on the gift. 50% of any gain in the value of the securities would be included in the donor's income for the year.[96]

As with other gifts, any amounts not claimed in the year of the gift may be carried forward for five years.

GIFTS OF PERSONAL-USE PROPERTY

A donor may give a gift of personal-use property, for example, a computer, a vehicle or furniture to a non-profit organization. "Personal-use property" includes property owned by a taxpayer and used primarily for the personal use or enjoyment of the taxpayer.[97] The donor would receive a tax receipt for up to the fair market value of the property at the time of the donation and could claim a tax credit based on the value of the gift.

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[95] *Income Tax Act*, s. 38(a.1). There are many specific considerations relating to gifts of shares and debt of private companies. Donors should seek professional advice when contemplating a gift of securities.

[96] There are special rules relating to gifts of non-qualifying securities (see *Income Tax Act*, ss. 118.1(13), (18), (19)). Donors should seek advice prior to making gifts of securities that are not publicly traded.

[97] *Income Tax Act*, s. 54 "personal-use property."

As with other gifts of capital property, 50% of any gain at the time of the gift is taxable. However, there is a deemed minimum cost of $1,000 for personal-use property.[98] If the proceeds of disposition are less than $1,000, there will be no gain. A capital loss is not allowed on the disposition of personal-use property, other than listed personal property described below.

Example: Stanley purchases a desk for $1,000 and donates it five years later to Western Conservancy Association for use in the office. At the time of the donation, the desk has appreciated in value and is valued at $1,400. Stanley has a deemed capital gain of $400:

Proceeds of disposition		$ 1,400
Less: adjusted cost base		$ 1,000
Capital gain		$ 400
50% of the gain is taxable.	0.50 x $400	$ 200
Stanley receives a tax receipt in the amount of $1,400 and may calculate his tax credit based on this amount.		
The amount of his tax credit would be	16% of $200	$ 32
Add:	29% of $1,100	$ 348
Credit against federal income tax		**$ 380**

The *Income Tax Act* provides special rules for a special category of personal-use property, known as "listed personal property."[99] Listed personal property is defined as works of art, jewellery, rare folios, manuscripts or books, stamps and coins.

Dispositions, including gifts, of listed personal property may give rise to a capital gain or loss. Losses arising on the disposition of listed personal property may only be offset against gains on the same type of property. Gains are treated in the same way as other capital gains; 50% of the gain is included in the donor's income. The donor will receive a tax receipt for the designated value of the property, up to the fair market value.

POSSIBLE ADVERSE CONSEQUENCES

In some circumstances, a gift of capital property may result in adverse tax consequences. Where the donation of capital property results in a deemed capital gain, an individual's taxable income will be increased. Generally in these circumstances there also will be a tax credit that will offset the gain and maximize the tax benefits from the gift.

In some circumstances, however, other benefits or credits to which a taxpayer is entitled are linked to the size of the taxpayer's income. A higher income might result in a clawback

[98] *Income Tax Act*, s. 46(1).

[99] *Income Tax Act*, s. 54 "listed personal property."

of benefits such as old age and other pension benefits, a reduction or loss of the age credit available to those taxpayers over 65,[100] or a reduction or loss of child benefits.

In addition, depending on the donor's circumstances, the donor may be required to pay alternative minimum tax.[101] Alternative minimum tax was introduced for 1986 and subsequent years to extract a minimum amount of tax. Again, depending on the donor's circumstances, alternative minimum tax may be creditable against future taxes payable.[102]

In any of these circumstances, a donor could elect to designate the donor's cost of the property as the value of the gift. There would be no capital gain attributed to the donor and no resulting increase in income for the year.

TAX CONSIDERATIONS FOR RECIPIENTS OF GIFTS

The *Income Tax Act* imposes a number of restrictions and obligations on registered charities.[103] This *Guide* refers only briefly to some of these. Organizations that receive gifts should seek advice from tax and legal advisers about the tax consequences of the gifts and about maintaining charitable status generally.

For more information about the requirements related to registered charities, see CRA publications including *Registered Charities and the Income Tax Act,* RC4108(E) 1204, and *Registering a Charity for Income Tax Purposes*, T4063(E) Rev. 01. For general information of interest to registered charities, see the *Registered Charities Newsletter.* All publications are available on the CRA website at http://www.ccra-adrc.gc.ca/

CHARITABLE STATUS

To be able to issue donation receipts for donations, an organization must be a qualified donee, which includes a registered charity within the meaning of the *Income Tax Act*.

A "registered charity" is

(*a*) a charitable organization, private foundation or public foundation, within the meanings assigned by subsection 149.1(1), that is resident in Canada and was either created or established in Canada, or

[100] *Income Tax Act*, s. 118(2).

[101] See *Income Tax Act*, s. 127.5.

[102] A detailed explanation of alternative minimum tax is beyond the scope of this *Guide*. Those concerned about alternative minimum tax should consult their tax advisors.

[103] See *Income Tax Act*, s. 149.1. This section is derived in part from Susan Mehinagic, "Taxation and charities", prepared for a conference held by Pacific Business & Law Institute, in Vancouver, BC, February 18, 1998, pp. 1.7-1.14.

(*b*) a branch, section, parish, congregation or other division of an organization or foundation described in paragraph (a), that is resident in Canada and was either created or established in Canada and that receives donations on its own behalf,

that has applied to the Minister in **prescribed form for registration** and that is at that time registered as a charitable organization, private foundation or public foundation.[104] [emphasis added]

Organizations with charitable status may issue donation receipts for charitable donations made to the organization. In addition, registered charities are exempt from the payment of income tax.[105]

The only entities that can receive ecological gifts are certain registered charities, Canadian municipalities and the federal or provincial Crown. As explained below, only registered charities which include in their purposes "the conservation and protection of Canada's environmental heritage" or some similar statement of intent acceptable to the federal Minister of the Environment or the authority designated by the Minister are qualified to receive ecological gifts.

Along with the ability to issue donation receipts and attract donations come certain responsibilities and obligations. Registered charities that do not comply with all relevant requirements risk losing their charitable status and may be subject to special taxes. These responsibilities and obligations are discussed in the next sections of the Guide.

DISBURSEMENT QUOTAS

Each registered charity has a disbursement quota for the taxation year.[106] The disbursement quota is the minimum amount of the charity's income that is to be applied to its charitable purposes. Every charity should be aware of its disbursement quota because failing to fulfil the disbursement quota may result in loss of charitable status.

Disbursements that qualify for the disbursement quota are

- those spent on charitable activities;
- with some exceptions, those given to other charities; and
- certain deemed charitable expenditures.

Generally, charities must spend 80% of the amount of gifts[107] received in the preceding year on its charitable activities in the current year. Certain gifts are excluded from this requirement:

- a gift of capital by bequest or inheritance;

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[104] *Income Tax Act*, s. 248(1).

[105] *Income Tax Act*, s. 149.

[106] *Income Tax Act*, s. 149.1.

[107] Proposed amendments will change this to "eligible amount" of gifts to reflect the introduction of split-receipting.

- a gift subject to a trust or direction that it or property substituted for it must be held for at least ten years; and
- a gift from a registered charity.

Depending on the charitable purposes of the recipient charity, gifts of capital property such as land that the donor intends be held by the recipient could present problems for the recipient in meeting its disbursement quota. The value of the gift would be added to the amount of gifts received, thus raising the disbursement quota without providing any cash amounts to disburse.

When making a gift, particularly of capital property, donors may therefore wish to direct that the recipient holds the gift for at least ten years. The gift would then not be subject to the recipient's disbursement quota until disbursed. Charities should seek advice from their advisors about this issue and consider addressing the issue with potential donors prior to the gift.

What constitutes charitable activities or charitable purposes is not defined in the *Income Tax Act* but is a matter of common law and, therefore, has been the subject of much litigation. Each charity must monitor its expenditures to ensure that the required percentage of its disbursements is made in relation to its charitable activities. Although a charity may engage in non-partisan political activities that are ancillary and incidental to its charitable activities, amounts spent on other political activities are not considered amounts spent on charitable activities and therefore will not assist the charity in meeting its disbursement quota.[108]

LOSS OF CHARITABLE STATUS

Registered charities may lose their charitable status under the *Income Tax Act* for a number of reasons, including:

- failure to meet their disbursement quota;
- engaging in activities that do not qualify as charitable;
- failure to meet applicable statutory requirements;
- failure to file information returns;
- the improper issue of donation receipts;
- failure to keep proper books and records; and
- carrying on a business not related to the business of the charity.

Because of disbursement quota requirements and the obligation to issue a proper donation receipt, charities have a responsibility to ensure that all gifts are properly appraised to establish the fair market value of property donated to them.

[108] *Income Tax Act*, ss. 149.1(1.1), (6.2).

DONATION RECEIPTS

Registered charities have an obligation to issue a proper donation receipt. Part XXXV of the *Income Tax Regulations*, Receipts for Donations and Gifts, governs the content of receipts for donations and gifts. Donation receipts for gifts of property other than cash must contain, among other things,

- the day on which the donation was received,
- a brief description of the property,
- the name and address of the appraiser if an appraisal was done, and
- the fair market value of the property at the time the gift was made.

In addition, proposed changes to the regulations resulting from the introduction of legislation permitting split-receipting require that donation receipts now contain a description and the amount of the advantage, if any, and the eligible amount of the gift.

Part XXXV of the Income Tax Regulations is available on the Department of Justice web site at http://laws.justice.gc.ca/en/I-3.3/C.R.C.-c.945/130884.html#rid-130998

Interpretation Bulletin IT-110R3, June 20, 1997, *Gifts and Official Donation Receipts*, and *Gifts and Income Tax,* both available on the CRA web site at http://www.ccra-adrc.gc.ca/ also contain information about donation receipts.

SPECIAL TAXES

Registered charities and municipalities are generally exempt from the payment of income tax.[109] However, in some circumstances, penalty taxes may be levied when certain events occur.

- As discussed earlier, any charity or municipality that disposes or changes the use of an ecological gift without authority may be liable to pay a tax equal to 50% of the fair market value of the gift at the time of the unauthorized disposition or change of use. This tax could be imposed, for example, if land or a conservation easement, covenant or servitude is transferred from the recipient to another organization without approval.
- Recipient registered charities or municipalities contemplating a disposition or change in use of property that was the subject of an ecological gift should contact the Ecological Gifts Program to obtain more information about how to request approval for a proposed disposition or change in use.
- When the registration of a charity is revoked, the charity is required to pay a revocation tax within a year after the effective date of revocation.[110] The tax payable is equal to the fair market value of the assets of the charity on a specified valuation day plus the amount of receipted donations or inter-charity gifts received between that

[109] See above. See also *Income Tax Act*, s. 149(1).

[110] *Income Tax Act*, ss. 188(1) and (2).

valuation day and the day the tax is payable. The amount of this tax is reduced by the value of assets transferred to other registered charities, amounts spent on charitable activities and amounts used to pay debts and reasonable expenses.

- Other taxes may be imposed in relation to transfers of a significant amount of property by charitable foundations intended to reduce the foundation's disbursement quota[111] or non-qualified investments of private foundations.[112] These topics are beyond the scope of this paper but should be explored by registered charities that fall within these categories.

GOODS AND SERVICES TAX (GST)

GST is payable by the recipient of goods or services at seven percent of the value of the consideration paid for the goods or services supplied.[113] The consideration may take the form of money, goods or services received. For example, barter transactions may have GST implications. However, as long as a donation is a true gift[114] and the donor receives nothing in return for the donation, there probably will be no GST implications for either the donor or recipient of the gift.

In general, the kinds of gifts discussed in this *Guide* will not be subject to GST. If there is any question that the donor of land or other property has received something in return for the transfer of the land, however, GST may be payable. In all cases, donors and recipients of donations should consult their tax advisors to ensure that GST is not payable on any particular transaction.

EXAMPLES OF TAX CONSEQUENCES OF GIFTS

Example: Phan owns three hectares of land on which his principal residence is located. The property contains approximately 2.5 hectares of wetlands that Phan wants to preserve in its natural state. His home is built on the remaining half hectare.

Phan decides to make an ecological gift of a covenant on his land to Western Conservancy Association. Under the terms of the covenant, the land cannot be subdivided and must be preserved in order to protect the fragile environment. The covenant covers the 2.5 hectares of wetlands.

Phan has his land certified as ecologically sensitive land and Western Conservancy Association is approved to receive the gift.

Phan purchased the land for $150,000. This is also his adjusted cost base for the land. At the time he granted the covenant to Western Conservancy Association, the

[111] *Income Tax Act*, ss. 188(3) and (4).

[112] *Income Tax Act*, s. 189.

[113] *Excise Tax Act*, RSC 1985, c. E-15.

[114] See the explanation of "gift" in Chapter 2.

land was appraised at $400,000. Using the "before-and-after" method, the appraiser valued the covenant at $50,000. This is also the fair market value determined by the Minister of the Environment.

Placing the covenant on the property resulted in a deemed disposition, the proceeds of which were $50,000, the appraised fair market value of the covenant. The appraiser determined that the value of the covenant at the time of acquisition was $18,750.[115] This is the adjusted cost base of the covenant. Phan designates the fair market value as the proceeds of disposition and the value of the gift. He receives a tax receipt for $50,000.

Phan has other income of $85,000 for the year.

Calculation of Phan's taxable income		
Fair market value of covenant		$ 50,000
Adjusted cost base of covenant		$ 18,750
Capital gain		$ 31,250
Taxable capital gain	25% x $31,250	$ 7,813
Plus: Phan's other income		$ 85,000
Net income for the year		$ 92,813
Taxable income		**$ 92,813**

[115] Using the newly proposed formula explained above for calculating the cost base of the covenant.

Donation Limit Calculation		
100% of gift available (because this is an ecological gift)		$50,000
Amount of donation (and tax receipt)		$ 50,000
If he claimed the full tax credit in the year of the gift, the amount of the credit would be		
	16% of $200	$ 32
	Add: 29% of $49,800	$ 14,442
Total tax credit available		$ 14,474
As the calculations below show, this credit would more than offset the additional tax Phan would be required to pay because of the deemed capital gain.		
Phan's federal tax payable without the donation:		
Tax on first $61,509 of income		$11,687
Add: 26% of balance ($85,000-$61,509=$23,491)		$ 6,108
Federal tax owing		**$17,795**
Phan's federal tax payable with the donation:		
Tax on first $61,509 of income		$11,687
Add: 26% of balance ($92,813-$61,509=$31,304)		$ 8,139
Federal tax owing before credit		$ 19,826
Less: total tax credit		$ 14,474
Federal tax owing if Phan takes the full credit		**$ 5,352**

If he chooses, Phan can carry forward any portion of the donation for up to five years. His tax credit would be lower in the year of the gift but he could spread the tax advantage over a longer period of time.

Example: Sonia has a 160 acre property that she has lived on and farmed for 30 years. The property is important habitat and has considerable heritage value. Sonia makes a gift of her property to Western Conservancy Association. At the time of the gift, the property is appraised at $800,000. The adjusted cost base of the property is $400,000.

Sonia's principal residence is located on the property. The appraisal indicated that the value of the principal residence and the half-hectare of land associated with the residence is $200,000 and that the amount of the adjusted cost base attributable to the principal residence is $100,000. Sonia has farmed part of the property and half her property is qualifying farm property under the *Income Tax Act*.

Sonia's other income for the year is $75,000.

Calculation of Sonia's taxable income[116]		
Fair market value of property		$ 800,000
Adjusted cost base of property		$ 400,000
Capital gain		$ 400,000
Less: Portion of gain exempt as principal residence ($200,000-$100,000)		$ 100,000
Capital gain		$ 300,000
Taxable capital gain	50% x $300,000	$ 150,000
Plus: Sonia's other income		$ 75,000
Net income for the year		$ 225,000
Less: capital gains deduction applicable to qualifying farm property	50% of taxable gain of $150,000 (i.e., relating to 1/2 property)	$ 75,000
Taxable income		$ **150,000**

[116] Taken substantially from materials presented by Susan Mehinagic of Grant Thornton on March 27, 1999 at the 1999 Land Trust Seminar Series held in Nanaimo, BC.

Donation Limit Calculation		
75% x net income	0.75 x $225,000	$ 168,750
Add: 25% of (taxable capital gain from donated property less capital gains exemption)	$150,000 ($75,000) 25% x $75,000	$ 18,750
Maximum amount of donation that can be used to claim a tax credit in year of the gift		$ 187,500
Amount of donation (and tax receipt)		$ 800,000
Donation carry forward Amount of donation Less: donation claimed in year of gift[117]	 $800,000 $187,500	$ 612,500
Note: If no capital gains exemption were claimed for the farm property, the donation limitation would be:	(75% x $225,000) plus (25% of $150,000)	$168,750 $ 37,500 $206,250
Note: If the donation of the land qualifies as an ecological gift, the donation limit is 100% of Sonia's net income or $225,000.		

Federal tax owing		
	Capital gains exemption	No capital gains exemption
Taxable income	$150,000	$225,000
Federal tax owing	$36,195	$57,945
Tax credit[118]	$54,439	$59,787
	(if Sonia claimed the full $187,500)	(if Sonia claimed the full $206,250)

117 Although Sonia could claim up to $181,250 in the year of the gift, or $225,000 if the gift were an ecological gift, she would not calculate the tax credit on the basis of any amount greater than her taxable income of $125,000. She would likely use an even lower amount in order to be able to claim the other non-refundable tax credits available to her, such as the basic personal tax credit.

118 Calculated as 16% of the first $200 of the donation limit amount and 29% of the balance. As noted above, Sonia would not be able to claim the maximum possible tax credit in the year of the donation. In both scenarios, the maximum credit available exceeds the amount of tax payable. Sonia would carry a larger amount forward. However, if her income in the next five years is too low, Sonia may not be able to use the full donation amount to claim tax credits.

CHAPTER 3

GIFT PLANNING

Many individuals recognize the value of planning for the most effective disposition of their property over their lifetime, including at the time of their death. The most effective disposition is the disposition that best suits the needs and wants of the person concerned and is the most economical taking into account those needs and wants. The most economical disposition is the disposition with the least amount of loss of monetary value because of taxes or other reasons.[119]

Although planning for the disposition of property involves planning to minimize tax, tax planning is by no means the only component. Individuals also must consider both their own need for the property for support and sustenance and how they want to dispose of the property for the benefit of family, friends or community, including for the benefit of ecological protection or other charitable purposes.

This section will discuss gift planning primarily from the perspective of planned giving for ecological protection purposes.

Anyone contemplating a donation, particularly of land or other property other than cash, should discuss the donation in advance with the intended recipient to ensure that the recipient wants the donation and is prepared to receive it.

BENEFITS OF GIFT PLANNING

Planned giving allows an individual to

- exercise control over the disposition of property both during the individual's lifetime and at the time of the individual's death,
- plan for the individual's own need for the property during his or her lifetime,
- decide how to dispose of the property during the individual's lifetime in a way that meets the individual's needs and wants,

[119] Maurice Cullity, Catherine Brown, Cindy Rajan, *Taxation and Estate Planning*, Carswell, 1996, p. 1-1, quoting J. Trachtman, *Estate Planning*, rev. ed., New York: Practising Law Institute, 1968.

- dispose of the property on death as the individual chooses, rather than according to a scheme set out in a statute,
- consider and, if desired, minimize the tax impact of the disposition of property both during the individual's lifetime and on death, and
- minimize probate fees payable on probate of the individual's will.

PROVIDING FOR DEPENDANTS

For many, providing for dependants and other family members is a primary concern. This concern may sometimes appear to conflict with other objectives important to the individual such as charitable giving and meeting the individual's own needs throughout his or her lifetime.

Depending on the nature and size of the estate, an individual may be able to meet many of these seemingly conflicting objectives through careful planning. It is beyond the scope of this *Guide* to discuss comprehensive estate planning intended to provide for dependants and other family members. However, aspects of this issue will be touched on in the discussion below of some of the options for disposing of property in a planned way both during one's lifetime and after death.

It is important to remember throughout that giving away property is considered a disposition of the property and will have the tax consequences discussed above in this *Guide*. Since a gift to a family member would not be to a qualified recipient, there would be no tax receipt for the gift. However, there are a number of specific rules in the *Income Tax Act* dealing with gifts of property to family members.

An individual can dispose of property during that individual's lifetime either by way of outright gifts or through measures such as the creation of spousal and other trusts for the benefit of family members. In many circumstances, these latter measures are designed to manage both the benefit to the beneficiaries from the gift of property and the tax consequences of the disposition.

For information about the special rules governing the transfer of property to family members and measures such as the creation of trusts for the benefit of dependants and other family members, individuals should consult their tax and legal advisors.

WILL PREPARATION

A fundamental step in gift planning is making a will. A will governs the distribution of certain property owned by an individual after the individual dies. In the absence of a will, an individual's property or estate is distributed according to the relevant statutory scheme.[120] Distribution according to the provisions of a statute may not benefit the individuals or causes that the deceased person wanted to benefit.

[120] In British Columbia, the *Estate Administration Act*, RSBC 1996, c. 122 governs the distribution of the property of a person who dies without having made a will.

A will does not govern the distribution of all property owned by the deceased person. For example, property held in joint tenancy passes automatically to the other owner or owners on the death of one of the joint tenants. However, property held by the individual with another as tenants in common is governed by the will.

By making a will, an individual (the testator) can, within certain limits,[121]

- choose his or her beneficiaries, including family members, friends and charitable causes,
- control the amount given to each beneficiary under the will,
- provide for contingencies that might occur before or after the testator's death, such as the death of a beneficiary, and
- control the administration of the estate for some time after the testator's death.

An in-depth discussion of will preparation is beyond the scope of this *Guide*. However, those wishing control over the disposition of property should consider making a will at the earliest opportunity, revise their will as needed and seek the advice of their tax and legal advisors.

TAXES PAYABLE IN THE YEAR OF DEATH

There are certain tax consequences on the death of a taxpayer that may result in a considerable amount of tax payable.[122] Most important for the purposes of this *Guide* is the treatment of capital property and registered retirement savings plans upon the death of a taxpayer.

CAPITAL PROPERTY

A disposition of all an individual's capital property is deemed to occur immediately before the individual's death. The individual is deemed to have received proceeds of the disposition in an amount of the fair market value of the property at the time of the disposition. Any capital gains or losses must then be included in calculating the taxpayer's income in the year of death.[123] This tax consequence does not arise if the capital property passes to the individual's spouse or a trust for the benefit of the spouse (a spousal trust).

[121] Some restraints are imposed through wills variation legislation which permits a spouse and children to apply to vary a testator's will to obtain greater benefit from the will. The courts have held that testators have a moral obligation to provide support in their wills for a spouse and children, including, in some circumstances, independent adult children.

[122] See *Income Tax Act*, s. 70. This *Guide* touches only briefly on some of the special tax rules pertaining to the year of death. Individuals should consult their tax and legal advisors for complete information. There are a number of choices under the *Income Tax Act* available to both the personal representative of a deceased individual and beneficiaries of the individual's estate. However, it is beyond the scope of this *Guide* to discuss these in detail.

[123] See the discussion above relating to the tax treatment of capital gains and losses.

All of the capital gains exemptions and tax credits discussed earlier in this *Guide* may be claimed where applicable. For example, the principal residence exemption may be claimed where the capital property was the deceased individual's principal residence. In addition, any gifts in the will to qualified recipients will be eligible for a tax receipt. The estate can claim a tax credit on the basis of the tax receipt.

In the year of death and the year preceding death, the limit on qualifying gifts (including gifts made in a will) is 100%. That is, the estate can claim a tax credit based on up to 100% of the deceased individual's income in the year of death and the year preceding death. Gifts made in a will are deemed to have been made immediately before the testator died, that is, in the year of death.[124]

However, this deemed disposition of capital property on the death of the property owner can result in a significant tax burden for estates comprised of capital property for which exemptions are not available. Furthermore, if the testator directs the property to be transferred in kind to beneficiaries, there may be insufficient cash in the estate to pay the tax owing without liquidating some of the assets.

REGISTERED RETIREMENT SAVINGS PLANS (RRSP)

An RRSP[125] affords individuals the opportunity to defer paying taxes on the money or other property, such as securities, contributed to the RRSP. In addition, the capital contributed to the RRSP may grow tax-free as long as it remains in the RRSP.

At the time of maturity of the RRSP, the individual may

- take the full value of the property in the RRSP and pay tax on the full value in that year,
- take annuity payments and pay tax on the annuity payments when they are received; or
- use the property in the plan to establish a registered retirement income fund or RRIF.

As a general rule, all amounts received by an individual from an RRSP are fully taxable as income in the year they are received. This is true whether the amounts are received from the collapse of the plan, as retirement income in the form of annuity or RRIF payments or on the individual's death.

If an individual dies before the maturity of an RRSP, generally the full value of the RRSP will be included in the individual's year of death income even if the amount in the RRSP is paid out to a beneficiary. One exception to this general rule is where the amount is paid or deemed to be paid to the individual's surviving spouse or, in certain circumstances, to the individual's children or grandchildren. In these circumstances, the amount in the RRSP will not be included in the deceased individual's income but will be included in the beneficiary's income. The beneficiary may choose to roll the amount into another RRSP or RRIF to avoid immediate tax consequences.

[124] *Income Tax Act*, s. 118.1(5).

[125] See generally section 146 of the *Income Tax Act*.

An individual may designate a qualified donee as the beneficiary of RRSP or RRIF proceeds. The individual's estate may claim a tax credit for this donation of the direct distribution of proceeds of the RRSP or RRIF to a qualified donee.[126]

Generally, if an individual dies after the maturity of an RRSP from which the individual has been receiving annuity payments, the value of the remaining annuity payments will be included in the income of the deceased individual for the year of death. The annuity payments will not be included in the deceased's income if the remaining payments under the RRSP are payable to the individual's spouse. In these circumstances, the payments are included in the income of the spouse.

PROBATE FEES

Probate fees are payable in British Columbia when a grant of letters probate (where an individual dies having made a will) or letters of administration (where an individual dies without having made a will) is sought. It is generally necessary for an executor or administrator to apply to the court for a grant of probate or letters of administration. In British Columbia, probate fees are based on the value of the assets disposed of by the will.

The present probate fee is comprised of a court filing fee plus $6 per $1000 of the value of assets sited in British Columbia in the estate between $25,000 and $50,000 and $14 per $1000 for the value over $50,000.[127]

Probate fees can have a significant impact, particularly for larger estates and those estates where property is transferred in kind to the beneficiaries and not reduced to cash amounts. For example, the total probate fee payable on an estate valued at $500,000 is $6,450, exclusive of the court filing fee, even if the entire estate consists of only one piece of real property. Where the deceased person has directed that property in kind, such as land, be transferred to the beneficiary, there may not be enough cash in the estate to pay the fees without liquidating some of the assets of the estate.

Probate fees are not payable on assets that are not disposed of under a will. For example, probate fees are generally not payable on the proceeds payable to a named beneficiary from an insurance policy. Nor are probate fees payable on property that is transferred by operation of law, such as property held in joint tenancy. Property held in joint tenancy is transferred to the surviving joint tenant or tenants because of the right of survivorship inherent in joint tenancy.

Probate fees can also be minimized by transferring assets prior to death in the ways that are discussed elsewhere in this *Guide*.

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[126] *Income Tax Act*, s. 118.1(5.3).

[127] *Probate Fee Act*, SBC 1999, c. 4.

GIVING PROPERTY AWAY DURING LIFE

Because of the potentially significant tax and other financial consequences of disposing of property upon death, many individuals consider disposing of property during their lifetime. Giving property away during one's lifetime allows a measure of control over when tax is payable and how much tax is payable at any particular time. While the tax consequences of the disposition of property cannot be avoided altogether, they can be managed in such a way as to minimize both the tax impact in the year of death and the overall tax impact of disposing of property.

For those individuals who wish to donate their estates for the benefit of conservation or other charitable causes, giving property away during their lifetime may also assist in avoiding the effect of the *Wills Variation Act*[128] or similar legislation in other jurisdictions.

Wills variation legislation allows the court to vary the terms of a will and order an "adequate, just and equitable" provision for the testator's spouse and children (including, in some cases, independent, adult children) out of the testator's estate where, in the opinion of the court, the will does not make adequate provision for their proper maintenance and support.[129]

In other words, a court has the power to order that all or some of the assets in a testator's estate be used for the maintenance and support of the testator's surviving family members. Donating property during one's lifetime may afford a greater measure of control over who is to receive the property.

OUTRIGHT GIFTS VS. TRUSTS

One of the impediments to disposing of property during one's lifetime is the need to use the property for support and sustenance. However, there are options available for giving property away while still retaining an interest in it. A gift may be outright, that is, a gift where the recipient acquires the same interest in the property given as the donor held immediately before making the gift. Such a gift might consist of any kind of property such as cash, land, shares or personal property. These gifts and their tax consequences have already been discussed in detail.

Alternatively, a gift may be made by the creation of a trust. A trust is the relationship that arises when

- a person called the trustee holds property either
- for the benefit of another person or persons called the beneficiaries, or
- for some object or purpose permitted by law,
- in such a way that the benefit of the property goes not to the trustee but to the beneficiaries or other objects of the trust.[130]

[128] RSBC 1996, c. 490.

[129] *Wills Variation Act*, s. 2.

[130] D.W.M. Waters, *Law of Trusts in Canada*, 2d ed., Toronto: Carswell, 1984, at p. 5.

The trustee may be a beneficiary of the trust.

An individual (the settlor) may create a trust during that individual's lifetime or in a will. A trust can be a method of both controlling property and giving it away. The beneficiaries of a trust could be, among others, either the settlor of the trust, a member of the settlor's family; or, a charity.

There are many reasons why someone may wish to create a trust rather than give an outright gift. These reasons include to[131]

- provide for the maintenance over time of the settlor of the trust or the settlor's dependants,
- centralize and preserve control of the settlor's business interests both during the settlor's life and after death,
- provide a degree of financial independence for an adult family member while postponing the time at which that family member will obtain full management and control of the property,
- conserve environmental values of property while allowing family members to use the property, and
- establish a charitable organization or foundation that will qualify for registration under the *Income Tax Act*.

The creation of a trust involves a gift of property. As we have seen, in the case of a gift, the donor is deemed under the provisions of the *Income Tax Act* to have disposed of the property at its fair market value and to have received that amount as the proceeds of the disposition.[132]

Depending on the property given to create the trust, there may be income, a capital gain or loss or recapture of capital cost allowance attributed to the settlor as a result of transferring the property to the trust. Unless the beneficiary of the trust is a qualified recipient, however, the settlor would not be eligible to claim a tax credit in respect of the gift.[133]

For tax purposes a trust generally is treated as a conduit to the extent that the income of the trust is paid or payable to the beneficiaries of the trust but is otherwise taxable in its own right. In other words, income from trust property that is distributed to the beneficiaries is taxed in the hands of the beneficiaries. The trust itself is taxed on income from trust property that is retained in the trust.

Example: Bridget sets up a trust of which her daughter, Annabelle, is the only beneficiary. She transfers shares to the trustee, Western Trust Co., for the trustee to hold for Annabelle's benefit. Under the terms of the trust, the trustee is to pay as much of the income from the shares to Annabelle as necessary to pay for her educational

[131] Maurice Cullity, Catherine Brown, Cindy Rajan, ***Taxation and Estate Planning***, Carswell, 1996, pp. 6-14 to 6-16.

[132] There are exceptions to this such as the alter ego trust and the joint spousal trust. In the case of each, property is deemed to be transferred to the trust during the settlor's lifetime at its cost rather than fair market value. Individuals should seek tax and legal advice when contemplating setting up a trust.

[133] Trusts in favour of qualified recipients will be discussed in greater detail below.

needs. The trustee may also cash in shares, if necessary, to pay for Annabelle's education.

In the first year, the income from the shares accumulates in the trust itself. This income is taxable as income of the trust. In subsequent years, the trustee pays all the income earned from the shares to Annabelle. This income is taxable as Annabelle's income.

KINDS OF PLANNED GIFTS

While this *Guide* is primarily concerned with the tax consequences of gifts of land and interests in land, some individuals may be in a better position to protect private land through gifts of other kinds of property to qualified recipients.

Planned charitable gifts may take a variety of forms. They may be either present or deferred.[134] They may be outright gifts or involve the creation of trusts. They may take the form of trusts of land and other property or of insurance policies or annuities. An individual may consider the kinds of gifts described below and, by using a combination of these gifts, benefit both family members and environmental purposes.

While the kinds of gifts described below generally may be made either during an individual's lifetime or on death, this section focuses on lifetime gifts.

It is important to remember that charitable gifts have potential consequences for the recipient as well as the donor. In the case of sizable gifts, particularly of property other than cash, the charity should carefully consider the potential consequences of each transaction.[135]

Gifts of conservation covenants

A gift to a qualified recipient of a conservation covenant will conserve the ecological values inherent in the land on which it is placed. At the same time, the donor could continue to own, and depending on the terms of the covenant, use the land in his or her lifetime and pass it on to the donor's heirs by will. Alternatively, a landowner might combine a gift of a conservation covenant with either the creation of a residual interest trust or the gift of the residual interest, both discussed below.

No matter how the landowner disposed of the land, the land would continue to be subject to the covenant and preserved in the ways specified by the terms of the covenant. This would protect the important ecological features of the land in perpetuity.

To the extent that the gift of the covenant had a value,[136] the gift might give rise to a capital gain and qualify for a tax credit in the year the gift was made. Any unused portion of the

[134] See the discussion in Chapter 2.

[135] See the discussion in Chapter 2.

[136] See the discussion in Chapter 2 of some of the considerations in valuing conservation covenants.

credit could be carried forward five years. A gift of a conservation covenant also could qualify for the increased tax benefits associated with ecological gifts.

Charitable bequests

A charitable bequest is a gift given to a qualified recipient in the donor's will. The gift could be a gift of land or other assets such as cash, shares or personal property. A bequest or gift made in a will, however, is revocable and does not give rise to a tax benefit to the donor at the time the will is made.

When the gift is made after the donor's death, the donor's estate will receive a tax receipt and may claim any tax credit associated with the gift. Depending on the value of the gift, there could be considerable tax savings on the donor's final tax return. Any portion of the tax receipt not used in the year of death may be carried back one year. There is no carry forward period for gifts made in the year of death.

Gifts of an interest in a trust

A charitable gift of a remainder or residual interest in a trust[137] allows the donor to give property away during his or her lifetime but to retain a financial interest in or a right to use the property given away.

A residual or remainder interest is the unconditional right of the recipient of the gift to the property in question upon the occurrence of a specified date or event, usually the death of the donor. This is the interest given to the recipient of the gift. The interest retained by the donor is generally referred to as the donor's life interest or life estate.

In such a trust:

- The trustee holds the property contributed by the donor.
- The donor collects the income from the property contributed (a charitable remainder trust) or retains the right to use the property for his or her lifetime or some other specified period of time (a residual interest trust).
- On the donor's death or at the end of the specified time period, the capital (that is, the property donated) is given to the charity that the donor named as the beneficiary when the trust was set up.
- The trust may also provide either for the income to be paid to another beneficiary for life or for the right of another beneficiary to use the property for that beneficiary's life after the donor's death before the property is ultimately transferred to the charity.

Any kind of property can be contributed to a remainder trust or residual interest trust including the donor's principal residence or other real estate, cash, shares or personal property such as art, coins, stamps or other valuable items. Generally speaking, a charitable

[137] This section is based in part on a seminar given by Susan Mehinagic of Grant Thornton on March 27, 1999 at the 1999 Land Trust Seminar Series held in Nanaimo, BC. See also IT-226R, available at http://www.ccra-adrc.gc.ca/menu/APAP-e.html.

remainder trust involves income-producing property such as shares, while a residual interest trust involves non-income producing property such as a principal residence or work of art.

The donation of a remainder interest in a trust or residual interest in real property allows a number of objectives to be achieved:[138]

- The recipient is ensured of future ownership of the property in question and can plan accordingly.
- The donor can continue to collect income from the property or to enjoy it during the donor's lifetime.
- The donor receives a tax credit based on the value of the residual or remainder interest.
- On the donor's death, the residual or remainder interest will not form part of the donor's estate for the purposes of probate fees, year of death tax calculation or wills variation legislation.

For example, a donor might create a trust and transfer a cash sum or income-producing shares to the trust for the benefit of a conservancy organization but retain the interest income from the cash or dividend income from the shares for the donor's life.

Alternatively, a donor might give his or her principal residence to the organization but retain the right to live in the principal residence for his or her life. The donor could also give his or her heirs the right to live in the residence for their lifetime after the donor's death. Upon the death of those heirs who would also have a life interest in the property, the property would pass to the registered charity, the ultimate beneficiary of the gift. Similarly, a donor could give a valuable painting, coin collection or stamp collection to a charity but keep the painting or collection to enjoy for his or her lifetime.

The transfer of property to the trust must be irrevocable. The donor cannot change his or her mind after the trust is set up. Nor does the donor have a right to encroach on any of the property donated to the trust. The only right the donor has is either to the income from the property where the property is income-producing property or to the use of the property for life or some other specified period of time.

When a donor transfers property to a charitable remainder or residual interest trust, the gift of property is considered to be a disposition to the trust at that time. The proceeds of the disposition are deemed to be the fair market value of the property at the time of the transfer to the trust. The gift will result in the tax consequences discussed earlier in this *Guide*. There may be a capital gain or loss for which the donor must account.

The donor also will receive a tax receipt for the gift. It is important to keep in mind that a gift to a qualified donee by way of a trust is a gift of an interest in the trust rather than a gift of the actual property donated to set up the trust. As a result, subsequent transfers of property to the trust will not qualify for a tax receipt.

[138] *Canadian Estate Planning Guide*, CCH Canadian Ltd., 1998, para. 12,190.

The tax receipt will be for the present value of the residual or remainder interest in the property rather than the fair market value at the time of the transfer of the property to the trust. The present value is calculated taking into account the fair market value of the property, current interest rates and the projected life expectancy of the person or persons with the life interest or successive life interests.

Generally speaking, the older the individual, the greater the value of the remainder or residual interest. If the donor is relatively young or if the donor wishes to create a series of life interests, the value of the gift may be quite low. Tax savings, therefore, may not be the primary motivation for the creation of a charitable remainder trust.

Examples of Life Expectancies and Present Value of $450,000 gift on death of life tenant[139]

Life Tenant (age)	Life Expectancy (Years)	Rate of Return (%)	Present Value
86/Female	7	6.5	$290,000
78/Female	12	6.5	$210,000
68/Female	20	7.0	$116,000
52/Male	29	7.0	$65,000
35/Female	50	7.0	$15,000

Gifts of a residual interest in real property

A donor could also retain a life estate or life interest and donate a residual interest in real property without creating a trust.[140] The requirements for this kind of gift are similar to the requirements for a gift of an interest in a remainder trust. The transfer of the residual interest to the qualified recipient must be irrevocable. The residual interest is valued in the same way as the interest in a remainder trust; that is, the tax receipt would be issued for the present value of the residual interest.

The gift may also give rise to a capital gain or loss. In the case of a gift of the residual interest in real property, the gain or loss is calculated by subtracting the adjusted cost base from the fair market value of the residual interest at the time of the gift. The adjusted cost base of the residual interest is calculated in a similar way to that of a covenant, as a reasonable portion of the adjusted cost base of the total property immediately before the gift.[141]

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[139] In materials presented by Susan Mehinagic of Grant Thornton on March 27, 1999, at the 1999 Land Trust Seminar Series held in Nanaimo, BC. Table based on 1983 Group Annuity Mortality Table. Successive life interests would reduce the value of the tax receipt.

[140] Interpretation Bulletin IT-226R, available at http://www.ccra-adrc.gc.ca/menu/APAP-e.html,addresses this kind of donation as well.

[141] *Income Tax Act*, s. 43 and IT-226R. See also the discussion in Chapter 2.

Life insurance

A donor may also benefit a conservancy organization or other qualified recipient by a gift of life insurance.[142] The donor may use either a new policy or an existing policy to make such a gift. A gift of life insurance is a way of providing a significant future gift at a reasonable present cost. By making a conservancy organization the beneficiary of a life insurance policy, the organization receives the insurance proceeds on the donor's death. Life insurance proceeds are not taxable in the hands of the beneficiary.

In these circumstances, there would be no tax credit available to the donor in respect of the premiums. However, if an individual designates a qualified donee as the beneficiary of life insurance proceeds on the individual's death, the donation of the direct distribution of proceeds qualifies for a tax credit that the individual's estate may claim.[143] The tax credit would not be available if the qualified donee is a policy holder or owner under the life insurance policy or the assignee of the life insurance policy.

Alternatively, the donor could name his or her estate as the beneficiary of an insurance policy and make a bequest in his or her will to a conservancy organization of the amount of the insurance proceeds. The donor would not be entitled to claim a tax credit for the premiums.

To receive a present tax benefit (rather than a benefit on death), the donor must also transfer ownership of the insurance policy to the recipient. Where the recipient is both the owner and beneficiary of the policy, the donor receives a tax receipt for each premium subsequently paid. The beneficiary receives the proceeds of the policy on the donor's death.

Another way in which life insurance could be used in planned giving is for a donor to benefit his or her heirs with an insurance policy and donate an ecologically valuable piece of land to a conservancy organization. This course of action would enable the donor to provide for family members while, at the same time, ensuring preservation of the land.

Direct designation

As explained above, the *Income Tax Act* permits individuals to designate a qualified donee as the beneficiary of life insurance, RRSP or RRIF proceeds on the individual's death. Donation of a direct distribution of proceeds qualifies for a tax credit available to the individual's estate.[144]

[142] See IT-244R3.

[143] *Income Tax Act*, ss. 118.1(5.1) and (5.2).

[144] Income Tax Act, ss. 118.1(5.1)-(5.3).

Gift annuities

A gift annuity[145] is another option for donors who wish to make a capital contribution to a conservancy organization but are concerned about having adequate funds to meet their living expenses. In making a gift of an annuity, the donor gives money to the charity that then either pays the donor an annuity or, more commonly, arranges to purchase an annuity from an insurance company.

The donor is guaranteed an income either for life or a specified period of time, depending on the terms of the annuity. If the donor pays more for the annuity than the total amount of annuity payments the donor is expected to receive, the excess amount is considered to be a charitable gift.

The size of the annuity payments is age-dependent and determined through an agreement with the recipient. The capital portion of annuity payments is non-taxable. Depending on how the annuity is structured, all or a portion of the annuity payments will be considered to be capital and will be non-taxable.

EXAMPLES OF PLANNED GIVING

Example: Kim and Leslie own four hectares on which their principal residence is located. The property contains nesting ground for herons. Kim and Leslie are determined to preserve the property in its natural state. They have a fifteen-year old son and also want to provide for him in the event of their death.

After discussions with Western Conservancy Association, a registered charity, Kim and Leslie decide to make an ecological gift of a covenant on their land in favour of Western Conservancy Association. Under the terms of the covenant, which they have certified as an ecological gift, the land cannot be subdivided and must be preserved in order to protect the heron nesting ground.

In their wills, Kim and Leslie provide that, on their death, their son will have a life interest in the property. After the death of their son, title to the entire property will be transferred to Ecological Conservancy Association, another registered charity. This year of death donation will be eligible for a tax receipt for the present value of the residual interest of the property — that is, the interest that Ecological Conservancy Association will receive on the death of Kim and Leslie's son.[146] The estate can claim a tax credit on the basis of the tax receipt. The covenant in favour of Western Conservancy Association will remain on title to the property.

Placing the covenant on the property results in a deemed disposition at the fair market value of the covenant.[147] Kim and Leslie must include any capital gain realized in their income for the year. However, Kim and Leslie receive a tax receipt

[145] See IT-111R2.

[146] There may also be a capital gain, depending on the value of the property.

[147] See the discussion in Chapter 2 on valuing covenants.

for the fair market value of the covenant. They are able to claim a tax credit on the basis of the tax receipt and to carry any unused portion forward five years from the time the time the covenant was granted.

In their wills, Kim and Leslie give the balance of their estates to their son.

Example: Sylvia owned shares worth $100,000. The shares were listed on the Toronto Stock Exchange. She purchased the shares for $75,000. This was her adjusted cost base for the shares. She received annual dividends from the shares in the amount of $7,500. Sylvia wanted to give the shares to Western Conservancy Association but needed the dividend income from the shares for her own support.

In 2003, Sylvia created a trust and donated the shares to the trust. Under the terms of the trust, the shares are held for Western Conservancy Association but Sylvia is entitled to the dividend income from the shares during her lifetime. On her death, both the shares and the right to receive the dividend income from the shares are given to Western Conservancy Association absolutely.

Sylvia cannot change her mind and take the shares back. Nor can she sell any of the shares to obtain their value in cash.[148] She is only entitled to the income generated by the shares.

At the time Sylvia created the trust, she was considered to have disposed of the shares to the trust and to have received the full fair market value of the shares as the proceeds of the disposition. The disposition gave rise to a capital gain of $25,000, 50% of which was taxable.[149] Sylvia included the gain in her income for 2003.

However, Sylvia also received a tax receipt for the present value of the remainder interest in the shares, the interest donated to Western Conservancy Association. She claimed a tax credit in the year the trust was created. Sylvia can carry forward any unused portion of the tax receipt for five years.

Example: Mohan lives in a house located on five hectares of land, four of which are comprised of wetlands. The house is his principal residence. The land is located outside an urban community that is growing rapidly. Mohan is very concerned about preserving this land in its natural state and does not trust that his daughter, his only relative, will preserve the land after his death. His daughter is married and lives in the urban community close to his home. However, Mohan also wants to provide for his daughter financially after his death.

[148] Under the terms of the trust, the trustee likely could sell the shares and buy others.

[149] If Sylvia had donated the shares directly rather than given an interest in a trust, the gift would have been a gift of listed securities. The amount of the capital gain included in Sylvia's income would have been 25% rather than 50%. See the discussion above about gifts of securities. However, in these circumstances, Sylvia would not have been able to retain the right to receive the income from the shares.

Mohan decided to give the property to Western Conservancy Association but wanted to continue to live on the property. In 1998, he created a trust. Under the terms of the trust, Mohan gave the property to Western Conservancy Association but retained the right to live on the property during his lifetime.

There was a deemed disposition of the property to the trust at the time the property was given to the trust. The proceeds of the disposition were the fair market value of the property at the time it was transferred to the trust. The disposition gave rise to a capital gain. However, Mohan received a tax receipt for the present value of the residual interest. The amount of the tax receipt was calculated taking into account the fair market value of the property, current interest rates and Mohan's life expectancy.

Mohan claimed a tax credit in the year of the gift based on the full amount of the tax receipt.

In order to provide for his daughter, Mohan used his tax credit to pay for a life insurance policy in the amount of $350,000 and named his daughter as beneficiary.

Mohan has no other significant assets in his estate. On his death, his property will be transferred to Western Conservancy Association and his daughter will receive the proceeds of the life insurance policy. There will be no significant year of death tax consequences and probate fees will not be payable on either the transfer of the property or the life insurance policy.[150]

[150] Alternatively, Mohan could have made an outright transfer of a residual interest in the property to Western Conservancy Association without creating a trust. He could retain a life estate or life interest allowing him to continue to live on the property for his lifetime. The tax consequences and calculations of a gift of a residual interest in the property would differ in some respects.

CHAPTER 4

PROPERTY TAX

WHAT IS PROPERTY TAX

Property tax is a tax levied on real property by either the province or a local government. It is based on the assessed value of the property. The revenue from property tax supports schools, hospitals and local government, including local services such as police, fire and waste removal services. The assessed value of property for property tax purposes is intended, in most cases, to be the fair market value of the property.

In British Columbia, various pieces of legislation govern property tax, including the *Assessment Act*,[151] the *Community Charter*,[152] the *Local Government Act*,[153] the *Taxation (Rural Area) Act*,[154] the *Hospital District Act*[155] and the *School Act*.[156]

Property assessment and taxation in British Columbia is a two step process. The Assessment Authority assesses the value and determines the classification of property. Tax authorities (the provincial or local governments) then apply their tax rates to the assessed value to determine how the tax burden will be shared among all property owners.

Where available, property tax incentives and relief generally take one or more of the following forms:

- a prescribed assessed value lower than market value resulting in lower property tax;
- a preferential tax rate applied to the assessed value; or
- a full or partial exemption from property tax.

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[151] RSBC 1996, c. 20.

[152] *Community Charter*, SBC 2003, c. 26. The *Community Charter* has recently come into force and authorizes municipalities to levy property taxes.

[153] RSBC 1996, c. 323. The provisions of the *Local Government Act* authorizing municipalities to levy property taxes have been repealed by the *Community Charter*. However, at the time of writing, the provisions authorizing taxation were still in force during a transition period. The *Local Government Act* continues to be the legislation authorizing regional districts to levy taxes in respect of services they provide.

[154] RSBC 1996, c. 448.

[155] RSBC 1996, c. 202.

[156] RSBC 1996, c. 412.

WHO ADMINISTERS THE PROPERTY TAX SYSTEM

PROPERTY ASSESSMENT — BRITISH COLUMBIA ASSESSMENT AUTHORITY

The British Columbia Assessment Authority is a Crown corporation continued under the *Assessment Authority Act*.[157] Its purpose[158] is to establish and maintain assessments of property that are uniform throughout British Columbia in accordance with the provisions of the *Assessment Act*. On an annual basis, the Assessment Authority prepares an assessment roll on which it records ownership and other details relating to real property in British Columbia. The Assessment Authority values all property in the province, classifies it according to its type and use, produces the assessment roll and mails assessment notices to property owners.

Taxing authorities in the province rely on the Assessment Authority to provide them with information on which to base their tax rates. To this end, the Assessment Authority provides the assessment roll to taxing authorities.

LEVYING PROPERTY TAXES — TAXING AUTHORITIES

Three main statutes govern levying and collecting taxes — the *Community Charter*, the *Local Government Act* and the *Taxation (Rural Area) Act*.[159] In addition, taxes are levied under the authority of other statutes such as the *School Act* and *Hospital District Act*.

Rural property, that is, property located outside a municipality, is taxed under the authority of the *Taxation (Rural Area) Act*. The provincial government sets the tax rate and levies and collects taxes in relation to rural property. Property located within a municipality is taxed under the authority of the *Community Charter*[160] or *Local Government Act* (in respect of services provided by regional districts). The municipal government sets the tax rate and collects property tax.

Taxing authorities generally collect all taxes levied against property located within their boundaries on their own account and on behalf of other bodies such as schools and hospitals, the Assessment Authority and regional districts.

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[157] RSBC 1996, c. 21.

[158] *Assessment Authority Act*, RSBC 1996, c. 21, s. 9.

[159] Property located in Vancouver is taxed according to the provisions of the *Vancouver Charter*, SBC 1953, c. 55.

[160] At the time of writing, the *Local Government Act* still authorized municipalities to levy taxes during a period of transition to authorization only under the *Community Charter*.

ASSESSING THE VALUE OF PROPERTY

Property tax is generally based on the market value of the property. According to the provisions of the *Assessment Act*, the assessor must determine the "actual" value of land and improvements. The actual value is defined as the market value.[161] Market value is

> The price expected if a reasonable amount of time is allowed to find a purchaser if both seller and prospective buyer are fully informed. For assessment purposes in British Columbia, market value is the most probable price that an unencumbered property would sell for on the open market on July 1.[162]

In determining a property's actual or market value, the assessor may consider, among other circumstances, its

- present use,
- location,
- original cost,
- replacement cost,
- revenue or rental value,
- selling price and the selling price for comparable property, and
- economic and functional obsolescence.[163]

As one commentator has stated:

> This approach [market value approach] to valuation of land recognizes more than its value in its present use, particularly in an area that is experiencing development. The fair market value of that property will reflect its "highest and best use," namely the most profitable, likely and legal use, assuming that a prospective purchaser is prepared to pay for the property's potential value. Use of this criterion for comparing and assessing properties has the advantage of creating a uniform standard and thus equity among taxpayers, although in practice this is not always followed and most legislation provides for preferential treatment in certain circumstances.[164]

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[161] *Assessment Act*, RSBC 1996, c.20, s. 19.

[162] BC Assessment website, at: http://www.bcassessment.bc.ca/5_system/5_real.html . See also the discussion above about valuation of land.

[163] *Assessment Act*, RSBC 1996, c.20, s. 19(3).

[164] Ian C. Attridge, *Conservation Easement Valuation and Taxation in Canada*, above at footnote 75, at p. 39.

In assessing the value of property, assessors will use one of the three fundamental approaches to valuation mentioned in Chapter 2 of this *Guide*:[165]

- cost approach;
- income approach; or
- direct comparison approach.

Not all property is assessed in the same way, however. The value of some property is determined using valuation rates prescribed under the *Assessment Act*. Such property includes continuous structures such as telegraph and telephone lines, pipelines, electrical transmission lines, and utility rights-of-way. There are also special valuation rules or prescribed valuation rates for railway property, farm land, forest land and major industrial property.

Forest land is land, other than a farm, that is either forest reserve land (private reserve land within the meaning of the *Forest Land Reserve Act*[166]) used for the production or harvesting of timber or land whose highest and best use is the production and harvesting of timber.[167] Forest land is classified as either managed or unmanaged.

Unmanaged forest land refers to land in the Forest Land Reserve for which an acceptable forest management commitment has not been made to the Provincial Agricultural Land Commission (ALC). This class also includes land outside the Forest Land Reserve which has its highest and best use for the production and harvesting of timber.

The managed forest land class includes:

- privately-owned forest land property;
- that is being used for the production and harvesting of timber;
- that is being managed in accordance with the *Forest Land Reserve Act* or *Forest Practices Code*;[168] and
- for which an acceptable management commitment has been made to the ALC or management plan approved under the *Forest Act*.

To be eligible for this class, the owner must successfully apply to have the land put into the Forest Land Reserve which is administered by the ALC. This class also includes land in the Agricultural Land Reserve for which an acceptable management commitment has been made.[169]

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[165] See the section on valuation in Chapter 2.

[166] *Forest Land Reserve Act*, RSBC 1996, c. 158. Section 61 of the *Private Managed Forest Land Act*, SBC 2003, c. 80, repeals the *Forest Land Reserve Act*. However, this section is not yet in force.

[167] *Assessment Act*, s. 24(1), definition of "forest land."

[168] An amendment to the Assessment Act, which is not in force at the time of the 2004 update to this publication, will change this to the *Forest and Range Practices Act*.

[169] *Assessment Act*, s. 24. See also the BC Assessment website at http://www.bcassessment.bc.ca/ . The government has recently passed the *Private Managed Forest Land Act* (SBC 2003, c. 80) which repeals the *Forest Land Reserve Act* and

The value of both managed and unmanaged forest land is assessed by determining the value of the bare land without the trees using a prescribed schedule of values. Until the trees are harvested, property taxes are based on this assessed value. After the trees on the forest land have been harvested, the assessed value of the trees is added to the bare land value. Generally, the value of trees harvested in any year is added two years later to the property's assessed value.[170] Managed forest land is taxed at a preferential rate.

Farm land is also given preferential treatment in the assessment process.[171] Land that meets the standards prescribed under the *Assessment Act* for classification as a farm[172] is assessed, according to prescribed values, at its value as a farm without regard to its value for any other purposes. This prescribed valuation will generally result in a lower assessed value than if the land did not qualify as a farm. If land ceases to meet the requirements for farm classification, it will be removed from the farm class.

Preferential tax rates as well as a partial exemption from property tax are available for land in an agricultural land reserve. These will be discussed below.

There is no special assessment category for ecologically sensitive land.

RULES RELATING TO CONSERVATION COVENANTS

There is only one specific property tax incentive program currently available in British Columbia with respect to conservation of ecologically sensitive land. Generally, in determining the actual value of property, the assessor must give consideration to any terms or conditions contained in a covenant registered against the property under section 219 of the *Land Title Act* (this includes conservation covenants as well as certain other covenants in favour of the government, local government or crown corporations).[173] In other words, the assessor must consider whether registering a conservation covenant has increased or decreased the value of the property. There is no similar direction with respect to other kinds of covenants or easements. The only exception to this is if a natural area exemption certificate under Part 7.1 of the *Islands Trust Act* applies to a parcel. In this case, the actual value of the parcel is deemed to be what it would be if the conservation covenant to which the natural area exemption certificate relates did not apply, and no natural area exemption certificate was in effect.[174] While there is only one special tax incentive program for conservation covenants, tax exemptions are available for qualifying land. The natural area exemption is discussed below.

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amends the *Assessment Act*. This Act, the relevant sections of which were not yet in force at the time of writing, applies to land classified as managed forest land under the *Assessment Act* in respect of which there is a management commitment to the Private Managed Forest Land Council. The Council is established under the Act. The amendments restrict the classification and valuation scheme in s. 24 of the *Assessment Act* to managed forest land as it is defined in the amended s. 24.

[170] BC Assessment website, at: http://bcassessment.gov.bc.ca/8_agfo/6_trees.html.

[171] *Assessment Act*, RSBC 1996, c. 20, s. 23.

[172] See "Standards for the Classification of Land as a Farm," BC Regulation 411/95.

[173] *Assessment Act*, RSBC 1996, c. 20, s. 19(7).

[174] *Assessement Act*, s. 19(7.1).

The interest of a covenant holder in property is not taxed. It is the property against which the covenant is registered that is taxed. The owner of the property is obligated to pay property tax on the property as a whole.

Registering a covenant will frequently result in a lower value since the covenant generally will restrict the use of the property. This is more likely to be the case for property located in or near an urban area where development pressures are higher. If registering a covenant against property results in a lower assessed value, property taxes, which are based on the assessed value, will also be lower.

Property owners who are of the view that the assessment of their property does not reflect the correct value have the right to appeal the assessment.

PROPERTY TAX EXEMPTIONS

Certain property is exempt from taxation.[175] For example, Crown land not occupied by anyone else, church property, colleges, universities, schools, and hospitals are exempt from taxation.

Only one specific exemption is available for land protected by a conservation covenant. This exemption, the natural area protection exemption within the Islands Trust Area is discussed below. No other specific exemptions for ecologically sensitive land or land owned or occupied by a conservancy organization are available. However, certain exemptions are available in relation to land owned by non-profit organizations. The availability of these exemptions differs depending on the location of the property and the taxing authority (that is, whether the tax is in relation to a municipality, school or hospital).

The provisions of the *Taxation (Rural Area) Act* govern rural property (property that is located outside of any municipality). Rural property that is owned or occupied by a non-profit organization and used exclusively for activities that are of demonstrable benefit to all members of the community where the land is located is exempt from property tax.[176] For example, land owned or occupied by a non-profit conservancy group and used as a park or wilderness preserve would likely be exempt from tax.

However, there is no absolute exemption from tax for property owned or occupied by a non-profit organization if that property is located within a municipality.[177] Such an

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[175] See, for example, *Local Government Act*, s. 339, s. 809 [regional districts], *Community Charter*, s. 220 [once the provisions repealing the relevant sections of the *Local Government Act* have been brought into force, the *Community Charter* will provide the taxing authority for municipal governments] and *Taxation (Rural Area) Act*, s. 15.

[176] *Taxation (Rural Area) Act*, s. 15(1)(q).

[177] There is a mandatory exemption in Vancouver for property owned by an incorporated charitable institution if the property is wholly used for charitable purposes — *Vancouver Charter*, s. 398(1)(c)(i).

exemption may be granted each year by bylaw at the option of the particular municipal government concerned.[178]

In addition, a municipal council may grant a tax exemption for riparian property subject to a conservation covenant, in favour of the municipality, protecting the property as riparian property. The bylaw granting the exemption also may provide that the owner of the property is required to pay all the tax exempted plus interest if there is a contravention of the terms of the covenant or if the covenant is discharged before the end of the exemption period.[179] Similar taxation provisions are in place for heritage properties subject to a heritage revitalization agreement or a section 219 covenant.[180]

Land that is classified as a farm under the *Assessment Act* or land in an agricultural land reserve receives a 50% exemption from school and hospital taxes so long as it meets the other legislative requirements.[181] If only a portion of a piece of land meets the requirements, that portion is eligible for the exemption.

NATURAL AREA PROTECTION TAX EXEMPTION

Under the *Islands Trust Act*,[182] certain property within the Islands Trust area is partially exempt from taxation. To qualify for the exemption, property must be

- in an area designated by the Islands Trust Council as an eligible area,
- land in relation to which there is one or more natural areas or amenities prescribed in the *Islands Trust Natural Area Protection Tax Exemption Regulation* (BC Reg. 41/2002, s. 2),
- subject to a conservation covenant, one of the holders of which must be the Islands Trust Council, a local trust committee or the Islands Trust Fund Board.[183]

In addition, the property owner must apply for and obtain a natural area exemption certificate. So long as a natural area exemption certificate has not been cancelled, the property is exempt from taxation, except under the *School Act*, to the extent provided by the Regulation. At the time of writing, qualifying property is exempt from property taxes to the extent of 65% of its assessed value. As mentioned above, if a natural area exemption certificate applies to a parcel of land, the land will be assessed at its full market value without taking into account the effect of the covenant.

Property with an exemption certificate is deemed to be Class 1 or residential property under the *Assessment Act*. The significance of this is discussed below.[184]

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[178] *Local Government Act*, s. 341, s.; *Community Charter*, s. 224.

[179] *Local Government Act*, ss. 343.1-343.2; *Community Charter*, s. 225.

[180] *Local Government Act*, ss. 342-343: *Community Charter*, s. 225.

[181] *School Act*, s. 130; *Hospital District Act*, s. 28.

[182] *Islands Trust Act*, RSBC 1996, c. 239, Part 7.1.

[183] *Islands Trust Act*, s. 49.1.

[184] *Islands Trust Act*, s. 49.3(5)(a).

A certificate may be cancelled at the request of the landowner, if the covenant on the property is contravened, if the covenant is discharged, or if the area is no longer designated as an eligible area.[185] On cancellation, the tax exemption ends. If a certificate is cancelled in circumstances other than that the area is longer designated, the owner must pay a recapture charge.[186]

DETERMINING THE TAX RATE

The taxing authorities (the provincial government or local governments) determine the tax rate each year. The tax rate is calculated as a percentage of the assessed value of property. More particularly, the tax rate is calculated as a percentage of the net taxable value of property, that is, the actual value less exemptions.

British Columbia has established a variable tax rate system. Taxing authorities are required to adopt a variable tax rate system under which individual tax rates are determined and imposed by the provincial Cabinet for prescribed classes of property.[187] There are nine classes of property: residential, utilities, unmanaged forest land, major industry, light industry, business/other, managed forest land, recreational property/non-profit organizations, and farm land.[188] Where a property falls into 2 or more classes, the assessor determines the share of the actual value of the property attributable to each class and assesses the property according to the proportion each share constitutes of the total actual value.

Under this variable tax rate system, different classes of property are treated differently. Some classes of property are given preferential treatment in the form of lower tax rates. For example, property in the residential class is assigned a lower tax rate than property in the business/other class.

The recreational property/non-profit organizations class is also taxed at a lower rate. This class includes property used for outdoor recreational activities such as golf courses, tennis courts, amusement parks, horseracing or parks and gardens open to the public. Property held or used by conservancy organizations does not fall into the non-profit category of this class of property.[189]

Farm land is given preferential treatment, both in the assessment process, in which it is statutorily assessed at less than market value, and in the lower tax rate applied. The preferential treatment is designed to encourage the preservation of farm land. In addition, some improvements on farm land are either wholly or partially exempt from property tax. Managed forest land is taxed at a lower rate than unmanaged forest land.

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[185] *Islands Trust Act*, s. 49.4.

[186] *Islands Trust Act*, s. 49.7.

[187] For example, *Local Government Act*, s. 359, s. 808, *Community Charter*, SBC 2003, c. 26, s. 197, *Taxation (Rural Area) Act*, s. 20.

[188] These classes are set out in the *Prescribed Classes of Property Regulation*, BC Reg. 438/81.

[189] *Prescribed Classes of Property Regulation*, BC Reg. 438/81.

There is currently no specific preferential tax treatment for ecologically sensitive land other than the Islands Trust natural area protection exemption. At the present time, the property tax system is not used as a significant vehicle to encourage the preservation of ecologically sensitive land.

SUMMARY OF PROPERTY TAX CONSIDERATIONS FOR ECOLOGICALLY SENSITIVE LAND

- With one exception, there is no special assessment category for ecologically sensitive land; nor are there preferential tax rates or specific property tax exemptions available for ecologically sensitive land.
- There may be tax exemptions available for land outside a municipality owned or occupied by a non-profit organization and used for charitable purposes.
- There may be an exemption available for such land located within a municipality if the municipal council has granted the exemption.
- Land that qualifies as farm or managed forest land may be taxed at a lower rate.
- Land in an agricultural land reserve may be eligible for a partial tax exemption.
- Municipalities have the power to choose to grant tax exemptions to the owners of riparian land subject to conservation covenants in favour of the municipality. However, if the terms of the covenant are breached or the covenant is discharged during the exemption period, the property owner may be liable for retroactive property tax plus interest.
- If a conservancy organization holds a conservation covenant or easement on a piece of property, its interest is not subject to property tax. The property in its entirety is taxable and the property owner is liable for the tax. Assessors, however, are required to consider the effect of conservation covenants on the value of land. If the covenant reduces the value of the property, property taxes will be lower as a result.

CHAPTER 5

PROPERTY TRANSFER TAX

WHAT IT IS

Property transfer tax is tax payable on the transfer of an interest in real property.[190] The amount of property transfer tax varies with the value of the interest in the property and is based on the fair market value of the property at the time of transfer. Fair market value is defined as the amount that would have been paid for the interest being transferred if a willing seller had sold it in the open market to a willing buyer.[191] At the present time, the amount of property transfer tax payable is one percent of the first $200,000 of fair market value of the property and two percent of the remaining fair market value of the property.[192]

WHEN IT IS PAYABLE

Property transfer tax is payable by the person acquiring an interest in property at the time of application for registration of the interest in the land title office.[193]

Property transfer tax is payable on registration against title to land on the transfer by any method (including sale, gift, bequest) of

- a fee simple interest in the land,
- a life estate in the land,
- a right to occupy the land under a lease;[194] or
- a right to occupy the land or require the transfer of a fee simple interest in the land under an agreement for sale.[195]

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[190] *Property Transfer Tax Act*, RSBC 1996, c. 378.

[191] *Property Transfer Tax Act*, s. 1, definition of “fair market value.”

[192] *Property Transfer Tax Act*, s. 3.

[193] *Property Transfer Tax Act*, s. 2.

[194] If the lease is registered in the Land Title Office against title to the land.

[195] *Property Transfer Tax Act*, s. 1, definition of “taxable transaction”, and s. 2.

Unless an exemption is available, property transfer tax therefore would be payable by a conservancy group if a fee simple interest in land is given (either as a gift or in a will) or sold by a property owner to the conservancy group. The tax would also be payable if a landowner transferred a life estate or leased land to the conservancy group.

Property transfer tax is not payable, however, when a common law covenant or easement, ***profit a prendre***, heritage conservation covenant, conservation covenant, statutory building scheme or statutory right of way is registered against title to land. Nor is property transfer tax payable upon registration against title to land of an option to purchase or right of first refusal.

EXEMPTIONS RELATING TO CONSERVATION EFFORTS

There are a number of exemptions from the requirement to pay property transfer tax,[196] of which several might be relevant to certain conservation efforts. For example, no tax is payable on a transfer of land to a regional district or a municipality.[197] Nor is tax payable on a transfer to a "registered charity" as defined in the *Income Tax Act* if the land will be used for a charitable purpose.[198] Similarly, no tax is payable on the transfer of land to a "designated educational institution" or an educational institution that receives grants under the *Independent School Act* where the land will be used for an educational purpose.[199]

The only direct tax relief for conservation efforts is contained in section 16 of the *Property Purchase Tax Act*. Under section 16, no tax is payable on the transfer of land that is subject to a conservation covenant in favour of the Crown. The covenant must provide that it will not be amended or discharged without Cabinet approval. The covenant itself requires Cabinet approval to be registered.

Where land subject to such a covenant is transferred, the transfer is exempt from property purchase tax to the extent of the fair market value of the interest being transferred that is subject to the covenant. This provides only limited tax relief since

- it requires the step of obtaining Cabinet approval in the first place, and
- is available only for covenants in favour of the Crown, not for other covenant holders under section 219 of the *Land Title Act*.

It is important to remember that relief from property transfer tax occurs only when it is payable, that is, on the transfer of property.

[196] See sections 5, 6, 14, 15 and 16.

[197] Section 14(3)(s). See Section 14 of the Act for a list of all of the exemptions available under the Act.

[198] Section 14(4)(b) – a registered charity as defined in section 248(1) of the *Income Tax Act*.

[199] Section 14(4)(c) and (i) – a designated educational institution as defined in s. 118.6(1) of the *Income Tax Act*.

APPENDIX 1
GLOSSARY

Adjusted cost base. The original cost of property adjusted in accordance with the provisions of the *Income Tax Act*.

Alternative minimum tax. A tax introduced to extract a minimum amount of tax from high-income individuals and trusts.

Beneficiary. A person entitled to benefit, especially under a trust or will.

Bequest. A gift made to someone in a will.

Capital cost allowance. A prescribed amount claimed on depreciable property that is acquired for the purpose of producing income and deducted from income from a business or property. Effectively, it allocates the cost of assets over the useful life of the asset.

Capital gain. A gain arising on the disposition of capital property, calculated by subtracting the adjusted cost base of capital property plus the cost of disposing of the property from the value of the property at the time of its disposition.

Capital loss. A loss arising on the disposition of capital property; generally, the excess of the adjusted cost base over the proceeds of disposition of the property, less the costs associated with disposing of the property.

Capital property. Generally, depreciable property and property in relation to which a gain or loss on disposition of the property would be a capital gain or a capital loss. Capital property may be any kind of property but does not include inventory of a business.

Charitable donations. Gifts made to registered charities.

Charitable remainder trust. A trust under whose terms the donor may use or collect income from the property for life or some other specified time after which the property is given to the charity named in the trust.

Conservation covenant. A voluntary, written agreement between a landowner and a conservancy organization or government agency, registered on title to property in the British Columbia Land Title Office under section 219 of the *Land Title Act*, in which the landowner promises to protect the property in the ways described in the covenant.

Covenant. A written document in which those signing the covenant commit to do or not do certain things or agree on a certain set of facts. Generally, a covenant contains promises by a landowner in relation to uses of the land limiting or prescribing the uses to which the land will be put. Covenants are frequently used to control the use of property or to preserve it. See also Section 219 covenant.

Deem. To hold, consider, or treat as if.

Deferred gift. A gift that cannot be revoked from which the recipient will not derive a benefit until some time after the gift is given.

Depreciable property. Property acquired for the purpose of gaining or producing income in relation to which a taxpayer can claim capital cost allowance. The *Income Tax Act* prescribes the kind of property against which capital cost allowance can be claimed. Land is not depreciable property.

Disbursement quota. The minimum amount of a charity's income that is to be applied to its charitable purposes.

Easement. A right of use of another's land, generally a right of passage over another's land.

Ecological gift. A gift of ecologically sensitive land or a covenant, easement or servitude registered against ecologically sensitive land that meets certain specified criteria in the *Income Tax Act*. Ecological gifts must be certified as such.

Gift. A transfer of property without consideration, that is, without the expectation of any benefit, advantage, rights or privilege in return.

Life estate or life interest. A grant of property to a person for his or her life or some other specified time.

Market value. The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus.

Net income. Total income less certain allowable deductions such as professional fees, RRSP contributions and child care expenses.

Personal-use property. Property owned by a taxpayer and used primarily for the taxpayer's personal use or enjoyment.

Principal residence. Under the *Income Tax Act*, a housing unit, leasehold interest in a housing unit or share of the capital stock of a co-operative housing corporation acquired for the sole purpose of acquiring the right to inhabit a housing unit owned by the corporation that is owned and ordinarily inhabited in the year by a taxpayer, the taxpayer's spouse or child.

Property. Under the *Income Tax Act*, property of any kind whatever, whether real or personal, including a right of any kind, a share of the capital stock of a corporation and the work in progress of a business that is a profession.

Property tax. A tax levied on real property by either the province or a local government based on the assessed value of the property, generally market value.

Property transfer tax. A tax payable under the *Property Transfer Tax Act* on the transfer of an interest in real property by the person acquiring the interest.

Qualified recipients. Under the *Income Tax Act*, registered charities, Canadian municipalities, the United Nations or its agencies, the federal or provincial Crown.

Real property. Land or an interest in land.

Recapture of capital cost allowance. The wholly or partly bringing back into a taxpayer's income of capital cost allowance previously deducted.

Registered charity. Under the *Income Tax Act*, a charitable organization, private foundation or public foundation, all as defined in the *Income Tax Act*, resident in Canada and created or established in Canada, that is registered as such.

Remainder or residual interest. A right to enjoy or own property in the future after the termination of all life interest or other time limited interests.

Section 219 covenant. A covenant made under section 219 of the *Land Title Act*. It includes conservation covenants and other covenants made in favour of government and government agencies.

Servitude. In Quebec law, a servitude is a right to use another's land. It is a burden on the land requiring the owner to permit access to the beneficiary of the servitude.

Split receipting. Dividing a receipt for a donation between the amount of the advantage received by the donor from the recipient and the amount that is a gift and eligible for a tax credit.

Tax credit. An amount calculated under the *Income Tax Act* that is subtracted from tax otherwise owing.

Taxable income. Net income less certain allowable deductions such as capital losses and capital gains deductions.

Total income. The total of all amounts received in the year as income within the meaning of the *Income Tax Act*. In the case of total income from a source other than employment, the income is net of expenses required to earn the income.

Trust. The relationship that arises when one person, the trustee, holds property for the benefit of another person, the beneficiary, or for some object or purpose permitted by law, in such a way that the benefit of the property goes not to the trustee but to the beneficiary or other objects of the trust.

APPENDIX 2

ORGANIZATIONS TO CONTACT FOR MORE INFORMATION

*This is not a complete list. For a more complete list of conservation and stewardship organizations, please refer to *Green Legacies: A Donor's Guide for B.C.*

NATIONAL GOVERNMENT AND NON- GOVERNMENT ORGANIZATIONS

Canadian Council on Ecological Areas
2067 Fairbanks Avenue
Ottawa, Ontario   K1H 5Y9
http://www.ccea.org/
The CCEA is a national organization that is committed to facilitating the establishment of a comprehensive network of protected areas which are linked together in a system that will protect Canada's terrestrial and aquatic diversity in perpetuity.

Canadian Nature Federation
Suite 606 – 1 Nicholas Street
Ottawa, Ontario   K1N 7B7
Phone: (613) 562-3447
Fax: (613 (562-3371)
http://www.cnf.ca/
The CNF is a non-profit, membership-based conservation organization. It is the national voice of Canada's naturalists, with a mission to protect the natural environment, its diversity and the processes that sustain it. The CNF produces the magazine Nature Canada *and directs four conservation programs: wildlands and seas conservation, endangered species conservation, bird conservation, and community education. The CNF works with affiliated naturalist organizations.*

Canadian Wildlife Service
Environment Canada
351 St. Joseph Blvd.
Hull, Quebec   K1A 0H3
Phone: (819) 997-1095
Fax: (819) 997-2756
http://www.cws-scf.ec.gc.ca/index_e.cfm
The CWS handles wildlife matters that are the federal government's responsibility, including protection and management of migratory birds, nationally important wildlife habitat and endangered species, as well as work on issues of national/international importance. The CWS also does research in many fields of wildlife biology.

Ducks Unlimited Canada
P.O. Box 1160
Stonewall, Manitoba R0C 2Z0
1-800-665-DUCK (3825)
Fax: (204) 467-9028
http://www.ducks.ca/
DUC is a non-profit charitable organization dedicated to the conservation, restoration and management of wetlands and associated habitats for the benefit of North America's waterfowl, wildlife and people.

Ecological Gifts Program
National Secretariat
Environment Canada
351 St. Joseph Blvd.
Gatineau, Quebec K1A 0H3
1-800-668-6767
Fax: (819) 953-3575
http://www.cws-scf.ec.gc.ca/ecogifts/intro_e.cfm
Environment Canada's Ecological Gifts Program enables individual and corporate landowners to protect nature by donating ecologically-sensitive land or a conservation covenant, easement or servitude to an environmental charity or government body and to receive tax benefits.

Land Stewardship Resource Centre of Canada
17503 45 Avenue
Edmonton, Alberta T6M 2N3
Phone: (780) 483-1885
Fax: (780) 486-9599
http://www.landstewardship.org/frameset.htm
A centre for developing partnerships for conservation programs, projects and exchanging knowledge that will help achieve environmentally sustainable land management. It provides an electronic clearinghouse with information on land-use conservation practices, programs, agencies and referrals for hundreds of resources.

Nature Conservancy of Canada
400 -110 Eglington Avenue West
Toronto, Ontario M4R 1A3
Phone: (416) 932-3202
1-800-465-0029
Fax: (416) 932-3208
http://www.natureconservancy.ca/
The NCC is a national charity dedicated to preserving ecologically significant natural areas through outright purchase, donations and conservation agreements. It works with individuals, communities, businesses and governments. There are also regional offices of Nature Conservancy of Canada. See below.

Wildlife Habitat Canada
Suite 310 – 1750 Courtwood Crescent
Ottawa, Ontario K2C 2B5
Phone: (613) 722-2090
1-800-669-7919
Fax: (613) 722-3318
http://www.whc.org/
WHC is a national, non-profit conservation organization that champions wildlife habitat stewardship by building capacity in the conservation community and affecting change in policies and practices having an impact on habitats.

BRITISH COLUMBIA GOVERNMENT AND NON-GOVERNMENT ORGANIZATIONS

BC Conservation Data Centre
Resources Information Branch
Ministry of Sustainable Resource Management
4th Floor – 395 Waterfront Crescent
P.O. Box 9358, Stn Prov Govt
Victoria, BC V8W 9M2
Phone: (250) 356-0928
Fax: (250) 387-2733
http://srmwww.gov.bc.ca/cdc/
The CDC collects information on rare and endangered plants, animals and plant associations in B.C. and provides a centralized source of information on the status, location and level of protection of these rare organisms and ecosystems.

Ducks Unlimited Canada
Provincial Office
954A Laval Crescent
Kamloops, BC V2C 5P5
Phone: (250) 374-8307
Fax: (25) 374-6287
e-mail: du_kamloops@ducks.ca
See description in previous section

Federation of British Columbia Naturalists
#307 -1367 West Broadway Avenue
Vancouver, BC V6H 4A9
Phone: (604) 737-3057
Fax: (604) 738-7175
http://www.naturalists.bc.ca/
Affiliated with Canadian Nature Federation.
The FBCN is an umbrella group for naturalist clubs in the province, providing a unified voice on conservation and environmental issues. The FBCN publishes the BC Naturalist, *sponsors meetings, workshops and camps, and supports projects such as the "Living by Water Project".*

Habitat Acquisition Trust
P.O. Box 8552
Victoria, BC V8W 3S2
Phone: (250) 995-2428
Fax: (250) 920-7975
http://www.hat.bc.ca/
HAT is a non-profit local land trust whose principal purpose is to promote preservation of locally environmentally important areas through the conservation of habitats on Southern Vancouver Island and the Gulf Islands. HAT works in co-operation with landowners, governments and other NGOs, concentrating on fundraising for acquisitions, conservation covenants, and land stewardship.

Habitat Conservation Trust Fund
Suite 100 – 333 Quebec Street
P.O. Box 9354 Stn Prov Govt
Victoria, BC V8W 9M1
Phone: (250) 387-9853
1-800-387-9853
Fax: (250) 952-6684
http://www.hctf.ca/
Created under the Wildlife Act (BC). Payments may be made out of the Fund for, among other things, conservation of biological diversity and habitat and the acquisition and management of land for the conservation or enhancement of fish or wildlife or habitat.

Islands Trust Fund
Suite 200 – 1627 Fort Street
Victoria, B.C. V8R 1H8
Phone: (250) 405-5174/405-5151
Fax: (250) 405-5155
http://www.islandstrustfund.bc.ca/
The Islands Trust Fund is a provincial Crown agency established to preserve and protect unique ecological or cultural properties in the Islands Trust Area. The Fund works with the community to protect special places in perpetuity through voluntary land donations, conservation covenants, land acquisition and public education.

TLC The Land Conservancy of British Columbia
2709 Shoreline Drive
Victoria, BC V9B 1M5
Phone: (250) 479-8053
Fax: (250) 744-2251
http://conservancy.bc.ca/
TLC works to protect plants, animals and natural communities that represent the diversity of life on earth, by protecting the lands and waters they need to survive. TLC also protects areas of scientific, historical, cultural, scenic or compatible recreational value.

The Land Trust Alliance of British Columbia
204-338 Lower Ganges Rd.
Salt Spring Island, BC V8K 2V3
Phone: (250) 538-0112
Fax: (250) 538-0172
http://landtrustalliance.bc.ca/
The Land Trust Alliance of BC provides education, research and services which support land trusts, conservancies and other agencies, organizations and individuals dedicated to the stewardship and conservation of natural and cultural heritage.

Nature Conservancy of Canada
202 - 26 Bastion Square
Victoria, BC V8W 1H9
Phone: (250) 479-3191
1-888-404-8428 (in BC)
Fax: (250) 479-0546
http://www.natureconservancy.ca/files/frame.asp?lang=e_®ion=8&sec=bc_welcome
See description in previous section.

Nature Trust of British Columbia
#260 – 1000 Roosevelt Crescent
North Vancouver, B.C. V7P 1M3
Phone: (604) 924-9771
1-866-288-7878 (1-866-28TRUST)
Fax: (604) 924-9772
http://www.naturetrust.bc.ca/
The Nature Trust is a charitable organization dedicated to the conservation of areas of ecological significance in BC. It identifies important areas, acquires key lands through gift, purchase, and leases, and encourages private/government sectors to set aside important areas.

Turtle Islands Earth Stewards
P.O. Box 3308
Salmon Arm, B.C. V1E 4S1
Phone: (250) 832-3993
1-888-917-TIES (8437)
http://www.ties.bc.ca/
TIES promotes sustainability of local ecosystems and livelihoods throughout the world by the application of land trust and land stewardship principles, and is involved in the protection of private lands by acquiring and administering property, working with community groups, holding workshops, providing printed information and providing alternative dispute resolution models.

West Coast Environmental Law
1001 – 207 West Hastings Street
Vancouver, B.C. V6B 1H7
Phone: (604) 684-7378
1-800-330-WCEL (in B.C.)
Fax: (604) 684-1312
http://www.wcel.org/
WCEL strives to empower citizens to participate in forming policy for, and making decisions about, protecting our environment. WCEL provides free legal advice, advocacy, research, and law reform services, as well as maintaining an Environmental Dispute Resolution Fund to help citizens' groups to solve environmental problems in their own communities.

Wild Bird Trust of British Columbia
124 – 1489 Marine Drive
West Vancouver, B.C. V7T 1B8
Phone: (604) 922-1550
Fax: (604) 922-8034
http://www.wildbirdtrust.org/
Dedicated to the protection of birds and their habitat and to the establishment of wildlife sanctuaries throughout the province.

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USEFUL PUBLICATIONS

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USEFUL WEBSITES

CANADA

BC Lands in Trust Registry http://www.landtrustalliance.bc.ca/registry/

BC Stewardship Centre http://www.stewardshipcentre.bc.ca/sc_bc/main/index.asp?sProv=bc

Canada Revenue Agency http://www.ccra-adrc.gc.ca/

Canadian Wildlife Service http://www.cws-scf.ec.gc.ca/

Ducks Unlimited Canada, especially Institute for Wetland and Waterfowl Research
http://www.ducks.org/ and http://www.ducks.ca/research/

Ecological Gifts Program http://www.cws-scf.ec.gc.ca/ecogifts

TLC The Land Conservancy of BC http://conservancy.bc.ca/

The Land Centre (Real Estate Foundation of British Columbia) http://www.landcentre.ca/

Land Trust Alliance of British Columbia http://www.landtrustalliance.bc.ca/

Nature Conservancy of Canada http://natureconservancy.ca/

North American Wetlands Conservation Council (Canada) http://wetlandscanada.org

Stewardship Canada http://www.stewardshipcanada.ca/sc_national/main/index.asp?sProv=ca

West Coast Environmental Law Association http://www.wcel.org/

Wildlife Habitat Canada http://www.whc.org/

UNITED STATES

Land Trust Alliance http://www.lta.org/

The Nature Conservancy http://www.tnc.org/

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