# Save Some Green

A handbook for U.S. taxpayers who own land in Canada

OLTA
ONTARIO LAND TRUST ALLIANCE

American Friends of Canadian Conservation

Grant Thornton
An instinct for growth™

Photo: C. Moray

Photo: bobcatnorth

Dear Friend of Nature:

This publication was created by people who are passionate about protecting Canada's irreplaceable wild places. Our goal is to help U.S. taxpayers who own property here and who share our love for Canada's natural heritage.

We hope that the practical tax information inside will inspire you to join our efforts to preserve these special places, so that future generations from both countries can enjoy them as we have.

Ontario Land Trust Alliance, a Canadian charity and American Friends of Canadian Conservation, a U.S. charity, formed a partnership to ensure that U.S. taxpayers who want to conserve their undeveloped Canadian properties, or donate to protect wild places in Canada, have the knowledge to do so. Our goal is to inform you about the options available to you so you can incorporate conservation into your planning for the future of your land in Canada. There are opportunities with which you and your advisors may not be familiar. Our scenario examples are all from Ontario but the handbook considers the federal tax implications for any U.S. taxpayer, who owns Canadian land, who is non-resident.

We hope that the information in this publication will help you find a practical path to follow to decide on the ideal circumstances for your property. We encourage you to consult your financial advisor, and to get in touch with your local land trust. There is a list of Ontario members on our website, links to organizations in other provinces can also be found there **www.olta.ca**.

In Ontario our incredible land trust community have protected over 85,000 acres of special natural places throughout Ontario, from Rainy Lake to Lake Erie to the Thousand Islands and many places in between. They are dedicated to protecting lands forever, and we exist to support them and build strength and excellence for all land trusts.

Thank you for joining us in the work of protecting land, water, and wildlife in Canada for now, and forever.

With best wishes,

Alison Howson
Executive Director

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Photo courtesy of the Burton MacLean Family

Photo courtesy of the Norton and Nelson families

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**Cover Photo:** Overlook along the Baldhead River just upstream from Lake Superior, Gary J. McGuffin 2011

# Contents of this handbook – and how it is organized



*Continued on page 4*

*Photo: Harry Slaunwhite*

*Photo: Anirudh Koul*

*Photo: Mary Lysne*

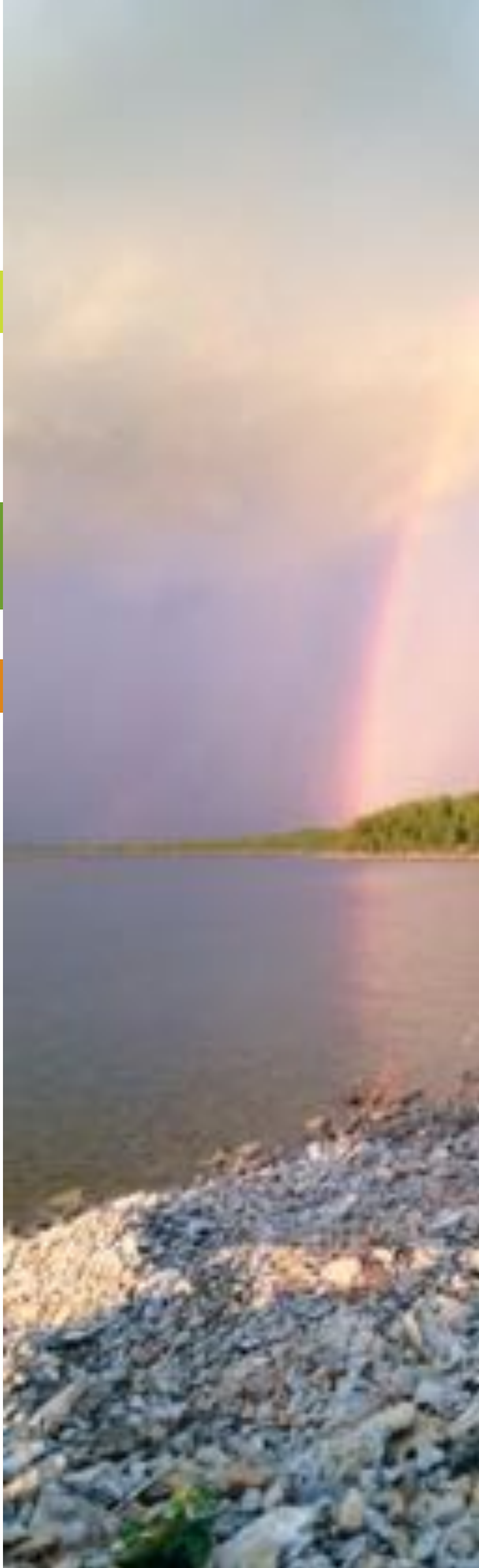


Photo: Alison Howson

# Introduction

Ecologically, Canada and the United States seamlessly blend in a myriad of landscapes that extend across the political boundary. Like the wildlife, citizens of both countries move – either seasonally or more permanently – across the border. This movement of people has shaped our families, economies and land ownership patterns. **As a result, there are U.S. taxpayers like you who own special natural lands in Ontario and other parts of Canada.**

Properties owned by U.S. taxpayers are concentrated in Canada's most scenic and biologically-diverse areas. The majority are within a day's drive of the border, in areas experiencing development pressure and rising property values. These landscapes are also where native species are most threatened by habitat destruction and other human impacts. Accordingly, U.S. taxpayers like you can play an important role in conserving Canada's natural heritage.

Canadian capital gains taxes can be a serious obstacle for families who want to pass a property to their heirs or simply want to make sure that their land remains a place for nature. **Fortunately, there are U.S. and Canadian tax benefits to help U.S. taxpayers conserve their Canadian lands and waters.** These benefits can make it financially feasible to keep your Canadian property in your family, if desired. They are also a valuable incentive that can assist families who want to protect their Canadian properties as a legacy for future generations. **In the Canadian conservation community, we refer to U.S taxpayers conserving lands in Canada as participating in "cross-border conservation."**

This document was created by the Ontario Land Trust Alliance (OLTA) and American Friends of Canadian Conservation (American Friends) to increase protection of Canada's natural heritage through cross-border conservation. It explains what will be helpful for you, as a U.S. taxpayer and owner of Canadian property, to know about the Canadian tax system, how it differs from the U.S. system, and how the two interact to create challenges and opportunities for cross-border conservation. It can benefit you, and **ensure the land you love retains its natural values in the future.**

**This handbook touches on the key tax components of U.S. taxpayers' decisions about whether, when, and how to conserve their Canadian properties. It is not intended to provide tax or legal advice. To fully understand how the tax components mentioned will have an impact on your situation, you must confer with your accountants and lawyers in the U.S. and Canada.**

The tax information provided in this handbook is broadly applicable across Canada. The case studies assume that the disposition of property will be in Ontario and subject to the federal non-resident surtax rather than Ontario provincial tax. The calculations do not consider any other province's tax regulations that might apply to a non-resident.

Photo: Toby J. Thorne

Photo: Michael J. Laporte

# SECTION ONE

## Key concepts of cross-border conservation

- All the tax benefits described here involve working with a charitable land conservation organization or government agency.
- There are four types of charitable land conservation organizations – donees – considered here who may receive these charitable gifts of land, or interest in land.
- The donee's charitable status and the country in which it is located will determine the potential tax benefits associated with the gift.
- The tax benefits result from charitable gifts of land, or an interest in land, such as a conservation easement, to one of the donees.
- Land conservation organizations have property acquisition criteria to guide their decisions about which properties to protect with their limited funding. Yours may, or may not, qualify.
- The options described here are for people who want to conserve the natural features of their property in the long term and are prepared to work with qualified financial and legal advisors who are familiar with cross-border taxation and conservation to make it happen.

***A gift of your Canadian land may be eligible for conservation tax benefits when it:***

- has unique or important natural, geological, scenic, recreational, or other values
- provides habitat for an at-risk species[1]
- meets the criteria for "ecological significance" under the Ecological Gifts Program (page 16)
- advances a local, regional, provincial, or national conservation plan or program, or
- is considered a protection priority by a Canadian conservation organization or government agency.

[1] Both the Ontario and Canadian governments have species at risk legislation which categorizes species that are in need of protection – extirpated, endangered, threatened, or of special concern.

Ontario -- https://www.ontario.ca/environment-and-energy/species-risk-ontario-list

Canada -- https://www.registrelep-sararegistry.gc.ca/species/schedules_e.cfm?id=1

Photo: Rick Harris

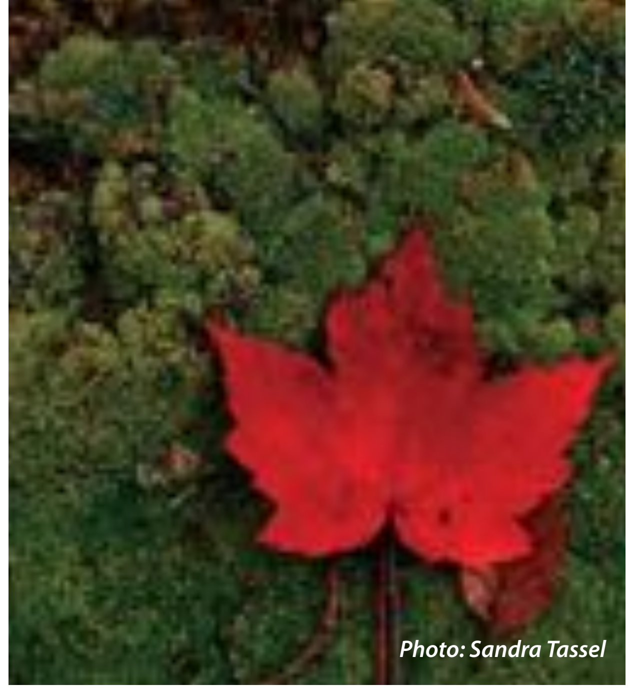

Photo: Sandra Tassel

## Key terms used in cross-border conservation

This is an alphabetical-order list of terms used in this handbook. Some of them are technical terms in the *Canadian Income Tax Act*. We're providing a simplified explanation. Please refer back here when you want to know more about a term in the text. Consult with your technical tax advisors and the Act for the complete definitions.

| | |
|---|---|
| Adjusted cost base (ACB) | The amount the current owner paid for the property plus certain acquisition costs and investments made to improve the property in a permanent way, for example, upgrading the road. The Canadian government uses the value of a property in 1972 as the basis for the adjusted cost base, when the current owner already owned it in 1972. |
| Canadian land trust | A charitable land conservation organization that is a Canadian registered charity dedicated to permanently conserving and protecting Canada's natural heritage. |
| Canadian qualified donee | A Canadian organization that CRA recognizes as able to issue charitable donation receipts for gifts it receives. For cross-border conservation, a Canadian qualified donee will most often be a Canadian land trust. It may also include other charitable land conservation organizations and government agencies. |
| Canadian tax credit | An amount that can be subtracted from the taxes that are owed. This is distinct from deductions which can reduce the taxpayer's income before taxes owing are calculated. Tax credits reduce the taxes owing. |
| Capital gain | The increase or gain in value of a property over the time it is owned. The capital gain is usually based on the fair market value of the property at the time of its disposition. It is calculated as the proceeds from disposing of a property through, for example, a sale or a gift or a will minus the adjusted cost base and minus expenses incurred selling or otherwise disposing of the property. A capital gain is taxable in Canada even on a gift of property or when it passes on to the next generation in a will. This is different from the tax rules in the U.S. |
| Capital property | Any property which, if disposed of, would result in a Canadian capital gain or capital loss. Cottages, recreational property, and other real estate are generally considered capital property. |


Photo: Rick Harris

| | |
|---|---|
| Certificate of Compliance | Non-resident owners of Canadian capital property are required to notify the Canada Revenue Agency (CRA) either before the disposition of the property or within 10 days after the disposition. The CRA will issue a certificate of compliance to indicate it is satisfied no tax will be due or it has received an amount sufficient to cover the tax on any capital gain. The certificate is often referred to as "clearance certificate". Clearance can be obtained in advance of a disposition using CRA's Form T2062 and providing the required information. |
| Conservation easement | A voluntary legal agreement between a landowner and a charitable land conservation organization or government agency to conserve the natural values of the land by limiting future uses, for example, subdivision. The agreement becomes a permanent part of the property title. The land is still privately owned and can be sold or gifted, subject to the conservation easement restrictions. There is no requirement for public access. In provinces other than Ontario, it may be referred to as covenant or a servitude. |
| CRA | Canada Revenue Agency |
| Deemed disposition | A transfer of Canadian property other than an actual sale. Gifts, partial gifts, bequests, or other changes in ownership are all deemed dispositions. |
| Deemed proceeds of disposition | The amount used to calculate the capital gain on a deemed disposition, usually the fair market value of the property at the time of disposition. |
| Donee | The person, corporation, or other entity receiving any type of donation. |
| Ecological Gifts Program (EGP) | A program administered by Environment and Climate Change Canada to promote the conservation of ecologically-sensitive properties. Made possible by the Income Tax Act of Canada, the program offers Canadian tax benefits for donations of such land or interests in land, such as a conservation easement. |
| Fair market value | The appraised value is defined as the price a buyer would pay for the property on the open market. The value of a property is usually determined by an appraiser, with approved qualifications. |
| Fee simple title | Full ownership in a property, entitling the owner to use the property in any manner consistent with federal, provincial, and local laws. |

*Continued on page 10*

Photo: Gary McGuffin

| | |
|---|---|
| Non-resident | Property owners who do not live in Canada, regardless of their citizenship. Non-residents are subject to Canadian taxation when they dispose of certain Canadian assets, such as real estate. |
| Prescribed donee | A tax designation in Regulation 3504 of the *Canadian Income Tax Act* identifying charities based outside Canada whose purpose is to hold title to land in Canada or to transfer land to a registered charity in Canada for conservation purposes. They are charitable land conservation organizations that aim to protect Canada's natural heritage. U.S. taxpayers who donate land or easements to a U.S. prescribed donee can utilize the election in subsection 118.1(6) of the *Canadian Income Tax Act* to eliminate or reduce Canadian capital gains on the donation. Such donations may also be tax-deductible in the U.S. |
| Split-receipt (a.k.a Bargain Sale, in the U.S.) | A sale in which the purchase price is less than fair market value. The difference between the fair market value and the sale price may be treated as a charitable donation. Both Canada and the U.S. recognize the donated portion of the transaction as being eligible for tax benefits. |
| Subsection 118.1(6) election | Subsection 118.1(6) of the *Canadian Income Tax Act* allows non-resident donors of capital property to "elect" to report the deemed proceeds of disposition as being any amount between the fair market value and the adjusted cost base on their Canadian tax returns if the transaction was a gift to a Canadian qualified donee, or a prescribed donee. If the donor elects to use the adjusted cost base as the disposition value, there is no capital gain and therefore no capital gains tax. |
| T2062 (CRA form) | Officially referred to as "Request by a Non-Resident of Canada for a Certificate of Compliance Related to the Disposition of Taxable Canadian Property." Submitting the T2062 to notify CRA in advance of a donation, or within 10 days after a donation, that the disposition will not be subject to capital gains tax makes it possible for non-resident donors to obtain their Certificates of Compliance without having to make payment to CRA. |
| Unified gift and estate tax credit | The unified gift and estate tax credit is the amount every person in the U.S. may gift to others without having to pay gift, estate, or generation-skipping taxes. In 2018, the amount was raised to approximately $11 million for individuals/ $22 million for married couples[2]. |

[2] Tax Cut and Jobs Act, Pub. L. No. 115-97 (2017)

*Photo: Sandra Tassel*

*Photo: Chris Ford*

*Photo courtesy Nelson and Norton families*

# SECTION TWO

## Seven important tax principles for cross-border conservation

Canadian tax rules can be a surprise to U.S. taxpayers and their advisors. Here is important information about Canadian tax rules and the tax incentives for cross-border conservation.

- Any disposition of capital property, or an interest in a capital property, including a gift, may produce a capital gain and could result in a tax liability. There are exceptions for primary residences and some transfers to a spouse.
- A portion of capital gains are income in Canada. Accordingly, U.S. taxpayers who own land in Canada will become Canadian taxpayers when they transfer their Canadian capital property and there is a gain. When you or your estate dispose of your Canadian real property you must file a Canadian tax return.
- Capital gains are taxed in Canada whether or not money changes hands. A sale, gift, bequest, or transfer to a corporation or trust, of appreciated capital property is likely to incur Canadian tax on the capital gains associated with the actual or deemed proceeds of disposition.
- The Canadian tax on capital gains is approximately 25% on most dispositions of capital property[3]. By law, this amount must be collected by the recipient from a non-resident seller or donor and remitted to the Canada Revenue Agency when the gift, bequest, or sale is completed, unless the seller obtains a clearance certificate.
- Capital gains can be reduced or eliminated by using the subsection 118.1(6) election, thereby avoiding or reducing capital gains tax liability, when Canadian land or an easement is donated to a Canadian qualified donee, or a U.S. prescribed donee.
- U.S. taxpayers who have Canadian-source income may deduct eligible gifts to Canadian charities, including donations of land or conservation easements, on their U.S. tax return.
- Gifts of land or easements in Canada to a U.S. prescribed donee are deductible against U.S. income because U.S. prescribed donees are U.S. charities.

These seven rules mean that conserving some or all of your Canadian property can reduce Canadian tax on capital gains for you or your heirs, and that U.S. tax benefits are also potentially available as a result of your gift. Read on to find out more about these tax tools.

[3] For a thorough introduction to Canadian capital gains visit https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/tax-return/completing-a-tax-return/personal-income/line-127-capital-gains/calculating-reporting-your-capital-gains-losses.html

## Overview of Canada's capital gains tax

As unexpected as it may be to Americans, under Canadian tax law, almost any disposition of capital property may generate a capital gain and therefore, potentially, a tax liability. Dispositions, as defined by the *Income Tax Act of Canada*, include virtually any transfer, even just a change to the way you hold title, such as adding your spouse or children as owners. Gifts and most donations of property - even though no money changes hands in these transactions – are also taxable dispositions. The capital gains tax liability is the same, whether the disposition is a gift or sale, unless you make use of certain available tax rules when you structure the transaction.

### *Calculating the tax liability of capital gains*

The capital gain on Canadian transactions is the difference between the current fair market value of the property and the adjusted cost base. The U.S. uses the same approach to calculating capital gains, when the property is sold resulting in an actual profit. Under the U.S. rules, gifts and bequests do not give rise to capital gains.

In Canada, a portion of capital gains are included in income and taxed at the same rate as other sources of income. The owner/transferor includes 50% of the capital gain in income and pays tax on that additional income at their Canadian marginal tax rate. The marginal tax rate is a sliding scale based on the individual's annual income – with rates that increase as income increases. The top marginal tax rate for a non-resident of Canada on a taxable disposition of Canadian real property is 48.84%[4] applicable to income over $202,800. Thus, the transfer of even a moderately-valuable property that has gone up significantly in value since its acquisition will produce a capital gains tax liability of approximately 25% of the capital gain. **Remember, your Canadian tax rate is determined by your Canadian income, which includes capital gains.**

**Basic example of Canadian capital gains calculations**

| | |
|---|---|
| Original cost (A) | $ 80,000 |
| Cost of improvements (B) | $ 200,000 |
| Adjusted cost base (C = A + B) | $ 280,000 |
| Transaction costs (D). | $ 55,000 |
| Total eligible property costs (E = C + D) | $ 335,000 |
| Current fair market value (F) | $ 1,000,000 |
| **Capital gain (G = F – E)** | **$ 665,000** |

### *The non-resident withholding*

The CRA requires that any buyer or recipient of a gift of Canadian land from a non-resident collect an amount equal to 25% of the fair market value and remit it to the CRA to cover potential capital gains taxes, unless the donor has obtained a certificate of compliance for the transaction. Canadian accountants who are experienced in non-resident taxation know how to complete and submit the required T2062 form to CRA to request advance clearance[5]. Done properly, the types of conservation gifts described in this handbook will generally not be subject to Canadian capital gains taxes and therefore should be eligible for zero withholding with advance clearance (See page 23 on the subsection 118.1(6) election for more information on advance clearance). Land trusts take note: the new owner becomes liable for the donor's tax unless the transaction has been cleared or the funds withheld when title is transferred.

[4] Combined federal-provincial rate in Ontario as of August 2017. It is subject to change.

[5] https://www.canada.ca/content/dam/cra-arc/formspubs/pbg/t2062/t2062-fill-11-16e.pdf

Photo: John Ross

### *Impact of Canadian capital gains on estate planning*

Canada does not have an estate tax per se. Taxation of capital gains serves a comparable purpose. When you give your Canadian land to a family member or anyone else or it transfers to your heirs through your will, that transaction will often be considered a disposition for tax purposes. If there is a capital gain, the transfer will be subject to Canadian taxation.

With certain exceptions, bequests are considered deemed dispositions. Transferring real estate to the next generation can be a taxable event in Canada! Unlike in the U.S., it can be very expensive to "just give it to the kids."

In general, a gift of real property is a "deemed disposition", which gives rise to a capital gain when the fair market value of the property exceeds its adjusted cost base.

In the U.S., estate planners and wealth managers routinely recommend transferring properties into trusts or corporations to remove the asset from the owner's estate. Alternatively, they may recommend gifting real estate to a U.S. charity in order to obtain a U.S. income tax deduction. If the property is in Canada, these transactions are all considered deemed dispositions and subject to Canadian capital gains taxes. U.S. estate planners may not be familiar with this potential for Canadian tax liability. This is important information when you are doing your estate planning.

**Tax on capital gain if property bequeathed to heirs**

| | |
|---|---|
| Deemed proceeds (H = F or fair market value) | $ 1,000,000 |
| Capital gain (G) | $ 665,000 |
| Taxable capital gain (I = 50% of G) | $ 332,500 |
| Top marginal tax rate (J) | 48.84% |
| Cash outlays associated with bequest | |
| Transaction costs (D) | $ 55,000 |
| Taxes payable (K = I x J) | $ 162,393 |
| **Total cash outlay (L = D + K )** | **$ 217,393** |

### *The Best Advice*

If you are a conservation-oriented U.S. taxpayer and want to reduce the financial burden of passing your Canadian land to your heirs, it may be worth considering cross-border conservation as an estate planning technique. No matter what, it is crucial that you work with qualified professional advisors to evaluate and prepare for capital gains taxes that can result from any disposition of your Canadian property.

# SECTION THREE

## How cross-border conservation can help

U.S. taxpayers, who own land in Canada that meets conservation criteria, may use one or more of the tax benefits listed below to help ensure the permanent conservation of their land.

U.S. taxpayers can benefit from:

- Canadian tax credits that offset Canadian tax
- Tax mechanisms that reduce or eliminate Canadian capital gains taxes
- A Canadian tax credit that reduces or eliminates taxes on other Canadian-source income or capital gains on other dispositions of property
- U.S. tax deductions that may reduce U.S. income and/or estate taxes, even on Canadian-source income

The chart below associates the tax benefits listed above with four types of donees. The donee's tax status and country in which it is located will determine the potential tax benefits available to you. An explanation of each category of donee follows the chart. The various types of gifts are defined in Section Four.

| ***Which type of donee can offer the tax benefits that may be helpful to your financial situation?*** | |
|---|---|
| **Desired tax benefit** | **A gift to donee type** |
| • reduce Canadian tax on Canadian-source income, and<br>• reduce or eliminate Canadian capital gains tax on disposition of a property owned in Canada | Canadian qualified donee – registered charity, government agency, or other qualified recipient |
| • make a gift that would not be subject to Canadian capital gains tax, and<br>• receive a full value tax credit that would reduce or eliminate capital gains tax on other Canadian source income or on other dispositions of property | Eligible recipient under Environment and Climate Change Canada's Ecological Gifts Program[6] |
| • reduce U.S. income taxes or estate taxes (no protection from Canadian capital gains taxes) | U.S. charity that is not a prescribed donee |
| • reduce U.S. income taxes or estate taxes, and<br>• reduce or eliminate Canadian capital gains on the gift | U.S. charity that is recognized by Canada Revenue Agency as a prescribed donee |

[6] Property must meet ecological criteria. For more information refer to https://www.canada.ca/en/environment-climate-change/services/environmental-funding/ecological-gifts-program.html

*Photo: Grand River Conservation Authority*

*Photo: Alison Howson*

## Types of donees

### *Canadian qualified donee*

A gift of land to a Canadian qualified donee, such as a land trust or government agency is not deductible on your U.S. tax return unless you have Canadian-source income against which to offset it. The same gift of land does make it possible to reduce or eliminate Canadian capital gains on the disposition using the subsection 118.1(6) election on your Canadian tax return.

The 118.1(6) election allows you to declare a disposition value between your adjusted cost base and the appraised value. Using the 118.1(6) election with this type of donee will reduce the amount of the gift and thereby reduce the tax deduction available to offset Canadian-source income. Discuss your options with your Canadian tax advisor. If you do not have Canadian income to offset, your accountant may advise you to use the adjusted cost base as the disposition value because that will reduce your capital gain to zero (page 23).

Giving land to a Canadian charitable conservation organization, such as a land trust, or a government agency may be a good option for you when:

- ✓ you have Canadian-source income, or
- ✓ your U.S. income is not sufficient to justify the additional expense of a bi-national transaction, or
- ✓ the anticipated value of the gift is relatively low and the Canadian donee is not willing or not able to pay the transaction costs.

### *Eligible recipient under Environment and Climate Change Canada's Ecological Gifts Program*

The Ecological Gifts Program (EGP) offers special tax incentives to encourage owners of Canadian land to conserve their ecologically-significant property. The Minister of Environment and Climate Change has approved certain environmental charities and municipal governments as eligible to receive these conservation gifts. Provincial and territorial governments, along with the Canadian federal government, may also receive gifts under the program (http://www.ec.gc.ca/pde-egp/).

When the EGP certifies a conservation donation, and the donation is made to an eligible recipient, Canadian taxable capital gains relating to the gift are eliminated. Only Canadian entities are eligible recipients of Ecological Gifts. Since they are U.S. charitable organizations, prescribed donees are not eligible recipients. They are, however, an alternative to receive donations that do not go through the EGP.

In addition, the tax benefits conferred upon certified Ecological Gifts can result in Canadian tax credits that can be used to offset other Canadian income, including taxable capital gains on another disposition. Therefore, a donation of a conservation property, a portion of a property, or a conservation easement through the EGP can result in tax credits that can be used to reduce the capital gains tax on a subsequent transfer or sale of real estate, or other Canadian assets, to the landowners' heirs, a trust, or a third party. The credit can be used for up to ten years so there is time to utilize it to implement your estate plan.

Gifts to an eligible recipient through the Ecological Gifts Program may fit your situation when:

- ✓ you want to eliminate Canadian tax on capital gains for your gift
- ✓ you have Canadian-source income
- ✓ you anticipate having a substantial Canadian capital gains liability or other Canadian income tax liability sometime in the next 10 years
- ✓ your U.S. income is not sufficient to fully utilize a U.S. tax deduction in the next five years, for a gift of land, or fifteen years for a gift of a conservation easement
- ✓ the property meets EGP's ecological guidelines, and
- ✓ an eligible EGP recipient is interested in accepting your donation.

Keep in mind that tax benefits related to an Ecological Gift will not be deductible against U.S. income. See the calculation in case study 4 for a demonstration of how Ecological Gift tax benefits work.

### *U.S. charity that is not a prescribed donee*

In theory, you could donate your Canadian property to any U.S. charity and it might be a deductible charitable gift in the U.S. However, if you donate to a U.S. charity that is not a prescribed donee, Canadian capital gains taxes on the gift cannot be avoided or reduced. This approach may be of greatest interest when your Canadian property has not gone up significantly in value. Note that most U.S. charities may be reluctant to accept a Canadian property because of the complexities and risks connected to the tax regulations and challenges for property management.

### *U.S. charity that is recognized as a prescribed donee*

For a gift to be deductible against your U.S. income, it must be given to a U.S. charity. U.S. prescribed donees are charities that accept gifts of conservation lands located in Canada and can transfer title of that land to a registered charity in Canada for conservation purposes. American Friends of Canadian Conservation (conservecanada.org) is a prescribed donee and a U.S. publicly-supported 501(c)(3) charity. It is the only entity with this dual tax status whose mission is to partner broadly with Canadian conservation organizations to protect properties owned by U.S. taxpayers.

The Canadian government created the prescribed donee tax classification to encourage non-residents to conserve their Canadian properties. It recognized that if it was good tax policy to offer Canadian taxpayers substantial incentives to protect ecologically-significant properties via the Ecological Gifts Program, it made sense to provide an incentive to foreign landowners.

Compared to a gift under the Ecological Gifts Program or a gift to a Canadian charity or government agency, a conservation gift to a U.S. prescribed donee generally does not produce as great a Canadian income tax benefit. Instead, the appraised value of the gift is a charitable contribution that is deductible on the donor's U.S. tax return, because a U.S. prescribed donee is a U.S. charity.

The U.S. tax deduction produced by a gift to a U.S. prescribed donee may be carried forward and applied to income over five years, in addition to the year in which the gift is made. Gifts of conservation easements produce deductions that may be carried forward for fifteen years.

*Continued on page 18*

*Photo: Corey Callow*

*Photo courtesy of the Lysne family*

*Photo: Gary McGuffin*

These carry-forwards are especially useful for donors with relatively low income or high Canadian property value.

As is the case with gifts to Canadian charitable conservation organizations or government agencies, Canadian tax on capital gains may be reduced or eliminated for conservation gifts made to a U.S. prescribed donee by using the subsection 118.1(6) election described on page 23.

Gifts to a U.S. prescribed donee may provide the optimal, bi-national tax outcome when:

- ✓ your income is primarily from the U.S., even when you are a citizen of Canada or another country, and you are a resident in the United States,
- ✓ you have sufficient U.S. income to fully utilize a U.S. tax deduction, and
- ✓ the value of your gift is likely to exceed $200,000 so that the size of the likely deduction will make the additional costs of a bi-national transaction worthwhile.

To choose a suitable recipient of your conservation gift, from a tax perspective, you and your advisors can evaluate the tax benefits available from each type of donee. When you are considering donating Canadian land, or an interest in land, a Canadian accountant who has experience with U.S. taxation can analyze which approach will provide the best tax outcome for you. This analysis is especially important should you have other Canadian property that has gone up in value and which you plan to transfer or sell.

## *Questions to consider regarding the future of your property*

- ✓ What future do I want for my property in Canada?
- ✓ What is my family's vision for it?
- ✓ Am I interested in donating some or all of my property for conservation purposes?
- ✓ Do I want to retain ownership while restricting future uses to conserve the property's natural character?
- ✓ How much capital gains tax will I (or my estate) expect to owe to the Canadian government when I dispose of my property or when I die?
- ✓ Can I provide enough funds to cover the capital gains taxes to ensure that my heirs won't be forced to sell the property to cover that tax liability?
- ✓ Do I have existing Canadian-source income on which I pay taxes (in either the U.S. or Canada) which could be reduced with a Canadian charitable receipt?
- ✓ In the future, will I have taxable Canadian income, including capital gains on a disposition of any Canadian assets, that can be offset by a Canadian charitable gift?
- ✓ Can I reduce my U.S. income taxes by making a gift of land or a conservation easement to a U.S. charity, recognized as a prescribed donee?
- ✓ Is my U.S. income sufficient to fully utilize a U.S. tax deduction?
- ✓ What information do I need to help me to make the best decision?
- ✓ Are my tax, legal, and estate planning advisors in Canada and the U.S. familiar with conservation as a financial tool to help me meet my goals?

# SECTION FOUR

## Types of cross-border conservation gifts

In the previous section, you learned about the Canadian and U.S. tax benefits that may be produced by a conservation gift to each of the four primary types of donees. This section describes the three most common types of conservation gifts and their potential tax advantages.

Every conservation project is unique. The natural values of your land and your family's objectives will determine the best conservation approach, as well as the ideal type of donee. Thorough consultations with your financial and legal advisors are also essential parts of the decision-making process. The information below can help you and your advisors formulate your preferred strategy.

Charitable land conservation organizations protect land in perpetuity typically using one of three main types of conservation gifts:

1. gift of land
2. gift of a conservation easement or other interest in land, and
3. bargain sale, also referred to as a split-receipt, of land or a conservation easement.

Any of the above types of gifts can legally be made to any type of donee. However, organizations may have internal guidelines, project selection criteria, or funding challenges that constrain their ability to accept a gift.

### *Gift of land*

You can create a conservation legacy for future generations by donating some or all of your land outright (referred to as a "fee simple title donation") to a donee that is willing to own and manage it to conserve its natural features. Such a gift may be the best option if you:

- want your land to remain in its natural state in perpetuity
- no longer want the responsibilities of land ownership and property taxes
- do not intend to pass the land to your heirs or don't have heirs
- want to reduce the size of your estate to solve U.S. estate tax issues
- can't afford to pay the Canadian capital gains tax associated with transferring your property to your heirs, or
- are interested in making your property accessible to the public in the future.

Case study 1 (page 28) illustrates the tax benefits associated with a cross-border fee simple gift.

### *Gift of a conservation easement*

If you want to retain ownership of your Canadian property while protecting its natural values, a conservation easement may be the ideal option. A conservation easement is a legal document, agreed to by the landowner and a conservation organization, that limits activities that could harm the property's natural characteristics. When you are seeking U.S. tax benefits, the donee must be a qualified conservation easement recipient[7] under U.S. tax regulations and be willing to hold the conservation easement.

*Continued on page 20*

[7] The recipient of a deductible conservation easement donation must be a qualified organization and also an eligible donee. IRC §§ 170(h)(1)(B), 170(h)(3), Treas. Reg. § 1.170A-14(c)(1).


Photo: Dan Tristram


Photo: Todd Harmer


Photo: Jack Salen

The landowner and the conservation easement holder negotiate the terms of the conservation easement considering their respective interests and the natural values of the property which both parties want to conserve. The conservation easement is registered in the public records just like the property deed. The restrictions will apply no matter who owns the land in the future.

The donee/holder of the conservation easement has the right to monitor and enforce the protective restrictions of the easement. This means that the donee/holder will work with you, and with future landowners, to uphold the intent and terms of the agreement in perpetuity.

An appraisal determines the fair market value of a conservation easement. The conservation easement's value is the difference between the value of the property without the restrictions in place and the value after the easement agreement is registered on title. That amount is a charitable gift from the landowner to the donee. For conservation easements to be tax deductible in the U.S. they must comply with Internal Revenue Code guidelines for a *qualified conservation contribution*[8].

A conservation easement is a legal tool with the flexibility to be tailored to a specific property to protect its natural characteristics and reflect the conservation interests of the landowner and the donee/conservation organization that will hold and enforce the conservation easement. A conservation easement can apply to all or part of a property. The Land Trust Alliance's website has more information about conservation easements (https://www.landtrustalliance.org/what-you-can-do/conserve-your-land/conservation-options).

Note: Regulations under Ontario's *Conservation Land Act* recognize U.S. conservation charities as eligible holders of conservation easements. Such a gift could be tax deductible against U.S. income, provided the easement meets all the U.S. standards. However, if the donee is not a prescribed donee, the gift of a conservation easement to a U.S. charity would be subject to Canadian capital gains taxes.

Consider a conservation easement when you want to:

- ✓ conserve your property in perpetuity
- ✓ keep the property in private ownership, rather than making a fee simple gift
- ✓ transfer it either through a gift or sale to an heir, other legal entity, or different owner while being assured the natural values are protected
- ✓ reduce capital gains on the subsequent transfer by reducing the fair market value of the property by limiting future uses
- ✓ lower exposure to U.S. estate taxes, or
- ✓ make a gift of the conservation easement to produce an income tax benefit in Canada or the U.S., depending on the country in which the donee is located.

Case study 2 (page 30) illustrates the potential tax benefits associated with a donation of a conservation easement, and subsequent disposition of the protected property.

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[8] https://www.law.cornell.edu/cfr/text/26/1.170A-14

### *Bargain sale/split-receipt gift of land or a conservation easement*

You can sell your land to a conservation organization at below its fair market value and donate the remainder of the appraised value as a charitable gift. Similarly, you can sell a conservation easement for below fair market value and donate the remainder of the appraised value of the conservation easement as a charitable gift. In Canada, this is called a split-receipt gift. In the U.S., it is known as a bargain sale. This partial sale/partial gift arrangement might be possible when your property is extremely valuable for conservation purposes and there is strong community support for its conservation. In general, land acquisition funding to support partial sale transactions is very limited in Ontario.

The charitable gift portion of the sale may reduce the tax payable on the Canadian capital gain arising from the money received for the sale. The gift may also produce an income tax deduction in the U.S. if the recipient/purchaser is a U.S. prescribed donee or other U.S. charity.

Split-receipting may be an option when:

- you intend to make a charitable gift of part of the fair market value
- you would like to receive payment for part of the value of the property
- the charitable receipt for the donation is useful to offset taxes that would otherwise be owed on the transaction
- the fair market value of the property and the gifted portion have been clearly ascertained through an appraisal, or
- the gifted portion is at least 20% of the property's fair market value.

Case study 3 (page 32) illustrates the tax consequences of a split-receipt transaction.

Photo: Dan Tristram

Photo: Alison Howson

Photo: Steven H. O. Jones

# SECTION FIVE

## Procedures and tax considerations

Most of the steps involved in a gift of Canadian land by U.S. taxpayers are similar to the requirements for comparable gifts of land within the U.S., or within Canada by Canadians. This section highlights the key differences with cross-border conservation transactions.

- As non-residents, U.S. donors are normally required to submit about 25% of the property value to CRA for Canadian capital gains taxes with any transfer of Canadian land or conservation easement. For charitable donations, the money is then returned when you file that year's Canadian tax return. If you do not want to submit this money to CRA, you can obtain a clearance certificate from the Canada Revenue Agency prior to making a donation of land or a conservation easement. To obtain the clearance, you and your Canadian accountant, complete form T2062 a "Request by non-resident for a Certificate of Compliance related to the disposition of Taxable Canadian Property"[9].

- As part of the process of obtaining the clearance certificate, you and your advisors will decide what value to elect as the "disposition value" for the gift so that the tax outcome is as advantageous as possible. Assuming that the donee is a registered Canadian charity, government agency, or U.S. prescribed donee, you can declare the disposition value to be any value between the adjusted cost base and the fair market value, thereby reducing or eliminating the capital gains tax. This election to avoid, or reduce, capital gains tax owing on the gift is described in subsection 118.1(6) of the Canadian *Income Tax Act*.

- If there are Canadian capital gains resulting from the transaction, for example in the case of a split-receipt donation, then the tax owed on the sale portion of the transaction must be paid when the transaction is completed.

- Appraisals must comply with Canadian standards and meet U.S. tax law requirements, regardless of the donee. There are clear standards for appraisals being submitted through the Ecological Gifts Program. U.S. tax law contains specific appraisal requirements for all conservation gifts. Recent amendments to U.S. tax law have increased the penalties for overstated appraisals and tightened requirements for appraisals[10].

[9] https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic72-17r6/ic72-17r6-procedures-concerning-disposition-taxable-canadian-property-non-residents-canada-section-116.html

[10] See the Appraisal Fact Sheet, in the Resources section of www.afoclt.org

- U.S. tax law contains specific requirements for content and wording of appraisals and conservation easement documents[11]. Canadian and U.S. donees must follow these requirements if the donor is a U.S. taxpayer. Only permanent conservation easements are eligible charitable gifts under U.S. tax law. In addition to specific wording, the easement document must also address issues related to mortgages on the property and mineral interests. American Friends of Canadian Conservation and its partners use a template easement that conforms to Ontario provincial requirements and the federal standards of both the U.S. and Canada.

- Canadian donees that plan to accept conservation easements from U.S. taxpayers should obtain recognition by the IRS as a Publicly-supported Charity[12] in order to be U.S. "qualified donees". Failure to do so can lead to U.S. estate tax issues for the donor's family in the future. **Note:** gifts to a Canadian donee that is recognized by the IRS as a foreign publicly-supported charity are not deductible against U.S.-source income, but can reduce U.S. estate taxes.

*Photo: Morgan Roblin*

[11] See Internal Revenue Code Section 170(h) and Treasury Regulations 1.170A-14 (Qualified conservation contributions) and 1.170A-13 (Recordkeeping and return requirements for deductions for charitable contributions).

[12] Information on applying for and maintaining status as a foreign Publicly-supported Charity can be found in the Resources section of American Friends of Canadian Conservation' website.

# SECTION SIX

## Introduction to the tax benefit case studies

Below are four invented case studies[13] describing U.S. taxpayers and their Ontario conservation properties. Each case study has an analysis of the U.S. and Canadian tax consequences of the donor's primary conservation options and is based on these assumptions:

- an individual U.S. resident taxpayer is making the donation, not a corporation
- the adjusted cost base of the property is its acquisition cost
- the Canadian federal and U.S. federal tax rates are for 2017 and are shown in brackets within calculations
- the U.S. state tax rate is for the state in which the fictional owner lives as of 2017 and are shown in brackets within the calculations; donors use the subsection 118.1(6) election to eliminate Canadian capital gains on the gifts to a Canadian qualified donee or a U.S. prescribed donee
- the land is located in Ontario. Any taxes or procedures that may apply in other provinces or territories are not considered.
- the donor has no other Canadian source income or capital property.

This handbook cannot provide examples for every circumstance. The four case studies address ownership circumstances that conservation organizations frequently encounter. The corresponding calculations illustrate the financial implications of the four most common types of transactions (See Section Four for more complete explanations of each of the four types of cross-border conservation gifts). Each of the case studies includes an explanation of the calculations and key things to know.

1. Gift of land: The financial impacts of the various alternatives for transferring full ownership of a property.
2. Gift of conservation easement: How a legal agreement to limit future development can reduce capital gains taxes and make it less costly to retain ownership or transfer a property.
3. Bargain sale/split-receipt donation: The outcome of a transaction in which the landowner/donor receives an amount of money for a sale at less than fair market value. The money received is taxable, but the donation portion produces tax benefits because it is a charitable gift.
4. Ecological Gift Program: Demonstrates circumstances under which an Ecological Gift could be an attractive option for a U.S. taxpayer.

For the first two case studies, the accompanying chart compares the tax consequences of three different property dispositions by a U.S. owner.

- Non-sale taxable disposition (Column 1): includes transactions such as a gift or bequest to one's heirs, moving the ownership to a corporation or trust, donating to a charity outside Canada, or modifying the ownership to add other individuals to title. These transfers may be taxable in Canada (page 7), even though no exchange of money is involved. The number at the bottom of this column represents the approximate amount of Canadian capital gains tax that would be due, based on the facts in the case study.

*Continued on page 26*

[13] Any resemblance to actual people, properties, or organizations is entirely coincidental as all names and places are fictitious.

- Conservation gift to a Canadian land trust (Column 2): by using the subsection 118.1(6) election (page 23) on their Canadian tax returns, the gifts described in the case studies are not subject to Canadian capital gains tax. However, the gifts are not deductible against U.S. source income. The calculation in this column shows a net of zero to demonstrate that no tax will be due. The difference between zero and the tax liability in the first column illustrates the tax saved by the landowners/donors by donating the property, or an interest in it.

- Conservation gift to a prescribed donee (Column 3): as with a gift to a Canadian land trust above, by using the subsection 118.1(6) election on their Canadian tax returns, the gifts described in the case studies are not subject to Canadian capital gains tax. However, unlike in either of the other two columns, the gift to a U.S. prescribed donee is tax deductible against U.S. source income. The negative number shown at the bottom of this column illustrates that there is a net savings from this gift rather than an expense as a result of the Canadian and U.S. tax benefits.

The third case study compares a taxable sale transaction to a split-receipt donation with a Canadian charity and a U.S. prescribed donee respectively.

- Taxable sale disposition (column 1): shows the potential tax ramifications of an outright sale. The number at the bottom represents the actual proceeds from which a real estate commission and other costs would have to be paid.

- Disposition at a discounted price and balance donated to a Canadian land trust (column 2): illustrates the cash proceeds produced by selling at a reduced price to a Canadian donee, with the balance of the property value donated as a charitable gift. Presumably, there would not be a real estate commission due on this transaction.

- Disposition at a discounted price and balance donated to a prescribed donee (column 3): demonstrates how the U.S. tax benefit could increase the net after-tax proceeds if a U.S. prescribed donee acquired the property and received the charitable gift.

The first three case studies do not include a comparison to the potential tax outcomes of an Ecological Gift because the hypothetical donors' U.S.-source income is high enough for them to fully utilize the tax benefits resulting from a donation to a U.S. charity.

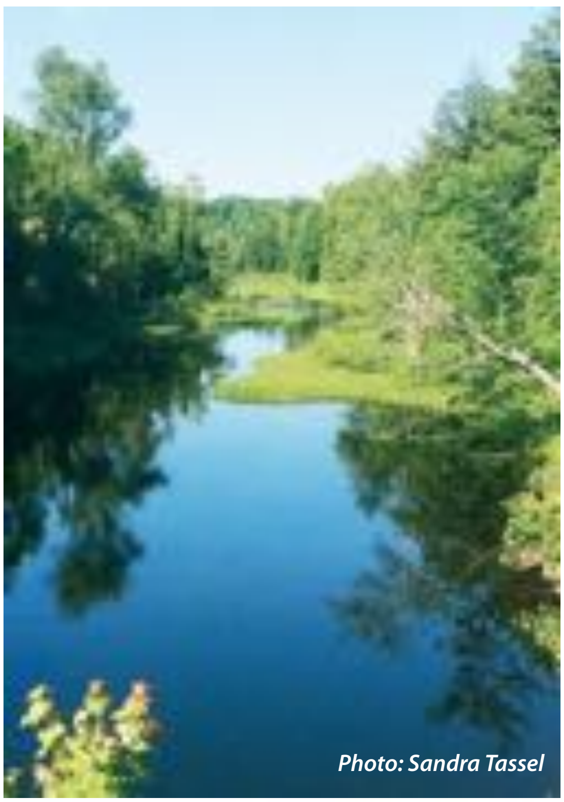
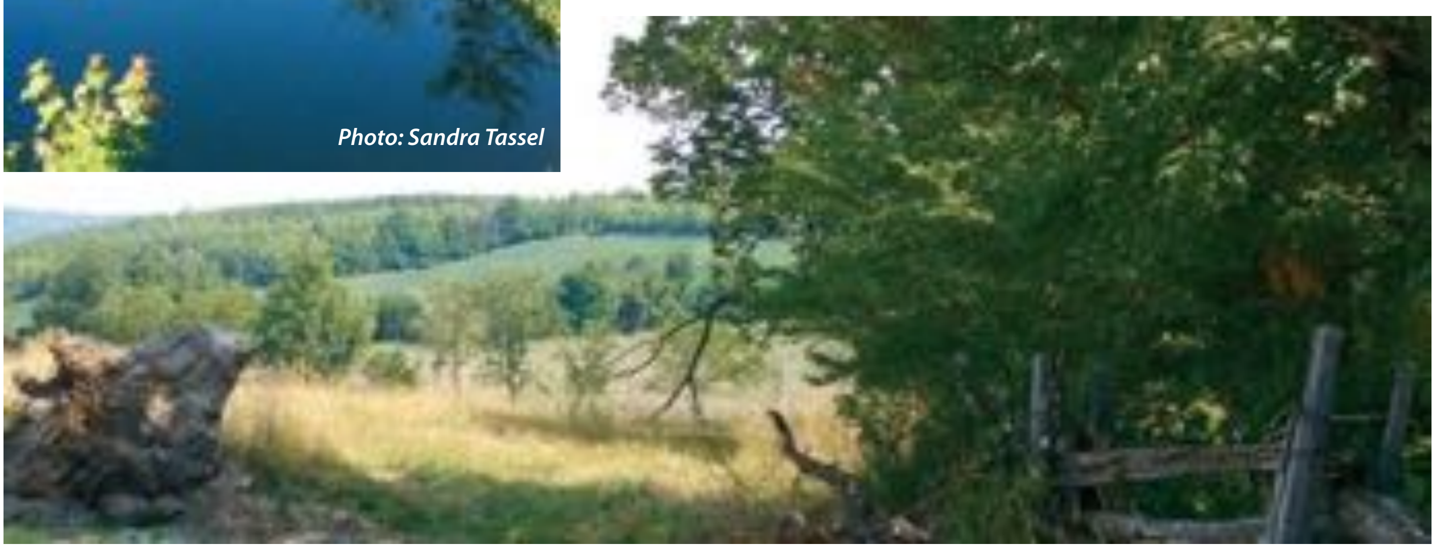


*Photo: Sandra Tassel*



The fourth case study focuses on the potential tax benefits of an Ecological Gift. It illuminates the difference between an Ecological Gift and the other likely alternatives for a landowner with similar circumstances.

In the Ecological Gifts case study, the landowner's financial and family circumstances would make an Ecological Gift an attractive option.

- Non-sale taxable disposition (column 1): shows the capital gains tax consequence of a non-sale taxable disposition.
- Donation of land through Ecological Gifts Program (column 2): details the tax benefits associated with the Ecological Gift itself.
- Disposition of remaining property within 10 years (column 3): demonstrates how the Ecological Gift can make a subsequent non-sale taxable disposition more financially beneficial.

For more information, please refer to Environment and Climate Change Canada's publication that provides tax scenarios specifically for Ecological Gifts (http://publications.gc.ca/site/eng/9.697176/publication.html).

### *Conclusion*

The tax implications of any transaction depend on the donor's particular circumstances and the structure of the transaction. To help you determine the most beneficial approach to land conservation for your tax situation, seek advice from independent tax and legal experts who understand the interaction between U.S. and Canadian tax legislation, who have experience with estate planning, and who know how to assess the impact of the various cross-border conservation options on your financial and family situation.

The case studies do not compare the financial outcome of a sale to a third party to that of a conservation gift. This handbook is for landowners who are motivated primarily by conservation. A desire to permanently conserve a property by donating it to a conservation organization or keeping a property "in the family" and available to future generations are core motivations for exploring cross-border conservation.

***The case study figures are illustrative and intended to convey tax concepts. Only qualified professionals can assess the tax outcome for a specific situation. Actual costs associated with a conservation gift vary considerably. Landowners must confer with possible donees to determine the range of likely expenses for their proposed transaction.***

Photo: Eric Parker

Photo: Explore The Bruce

Photo: Eric Parker

# Case Study 1: Ledge Island

Fee simple disposition

Martha McCann owns a small consulting firm in Duluth, Minnesota. Her annual taxable U.S. income is $200,000 per year. Nearly 20 years ago, she purchased an undeveloped three-hectare island in a large lake north of Thunder Bay Ontario for $100,000. Ms. McCann named the island for one of her favorite sites; the exposed rock ledge at the south end. Today the fair market value of Ledge Island is $500,000.

When Ms. McCann bought the island, she imagined building a cabin where she would spend four or more months each year after she retired. However, she has constructed only a pair of tent platforms; one for herself and one for her sister's family who come for at least a week every summer. The property is accessible only by boat via a short ride from the local marina.

Ms. McCann, who is single, recently decided she could not build on the island as she had hoped. Overseeing construction from a distance would be complicated. Now that she is ready to retire, maintenance costs for a second home seem burdensome. Camping has become less enjoyable for her so she is spending less and less time on the property. She is trying to decide how best to protect the natural features of Ledge Island, given her current circumstances.

One of her nieces, who is still in her 20s, expressed an interest in owning Ledge Island in the future. However, Ms. McCann is worried about giving the property to her niece because there is no way to predict where life will take her. Another option she is considering is giving the island to the Big Lake Land Trust. That organization has been successfully conserving shorelines and uplands in the area. Ledge Island features old growth forest that escaped the wholesale timbering of the early 1900s which makes the property a conservation priority.

The chair of the board of the Trust introduced Ms. McCann to the idea of donating Ledge Island to a U.S. prescribed donee so that her gift would be tax deductible in the US.

### *Understanding the case study 1 calculations*

- *The first calculation column analyzes a fee simple transfer/gift of the property to another party, the owner's niece in this case study. Ms. McCann would have to pay $94,000 in Canadian capital gains taxes when transferring the property to her niece.*
- *The second calculation column shows the financial implications of donating Ledge Island to a Canadian qualified donee, such as the Big Lake Land Trust. If Ms. McCann uses the subsection 118.1(6) election the gift would not trigger Canadian capital gains tax. However, Ms. McCann would not obtain any U.S. tax benefit for her gift.*
- *The third calculation column shows the result of donating the property to a U.S. prescribed donee. Because the organization is a U.S. charity, the gift would qualify as a charitable contribution and therefore be an eligible deduction on Ms. McCann's U.S. tax return. The number in parentheses in the final line indicates the total amount of financial benefit potentially available from this transaction.*

All amounts in U.S. dollars

| | Case Study 1 Calculations | Non-sale taxable disposition | Donation of land to Canadian land trust | Donation of land to U.S. prescribed donee | Notes |
|---|---|---|---|---|---|
| | **Disposition terms** | | | | |
| A | Appraised value | $500,000 | $500,000 | $500,000 | |
| B | Closing costs @ 3% | $15,000 | $15,000 | $15,000 | |
| | **Taxes on disposition** | | | | |
| C | Deemed proceeds or elected proceeds | $500,000 | $100,000 | $100,000 | In order to eliminate capital gains on the gift, Donor elected to declare the disposition value as the adjusted cost base using subsection 118.1(6) election |
| D | Adjusted cost base | $100,000 | $100,000 | $100,000 | Original cost plus cost of improvements |
| E | Capital gain (if any) = C – B – D | $385,000 | ***1** | ***1** | |
| F | Canadian federal capital gains tax = E x 50% x landowner's Canadian rate (up to 33%) | $63,525 | $– | $– | Canada taxes 50% of capital gains at rate determined by the owners' Canadian income, including 50% of capital gains. |
| G | Canadian federal surtax = F x basic federal tax (48%) | $30,492 | $– | $– | Canadian federal tax on amount of basic federal tax, in place of provincial tax |
| H | **Total Canadian taxes** = F + G | $94,017 | $– | $– | |
| I | U.S. gift tax = A x U.S. gift tax rate (up to 40%) | $153,200 | $153,200 | $– | Assumes use of one annual gift tax exemption of $14,000. |
| J | Gift tax credit (unified lifetime credit) | $(153,200) | $(153,200) | $– | |
| K | U.S. income taxes | $– | $– | $– | |
| L | **Total U.S. taxes** = I + J + K | $– | $– | $– | |
| M | **Total Canadian and U.S. taxes** = H + L | **$94,017** | **$–** | **$–** | |
| | **Potential Tax benefits** | | | | |
| N | Charitable gift portion - Canadian tax = D | | $100,000 | $– | Donor could elect a higher disposition value if she had Canadian income to offset. This value is converted to a donation credit in Canada. |
| O | Charitable gift portion - U.S. tax = A | $– | $– | $500,000 | Appraised value is the value of a charitable gift in the U.S. |
| P | Potential Canadian income tax saving | | | | Assumes no other Canadian source income or gains. |
| Q | Potential U.S. federal income tax savings = A x U.S. federal tax rate (39.6%) | $– | ***2** | $198,000 | |
| R | Potential state tax savings (MN) = A x state tax rate (9.85%) | $– | $– | $49,250 | |
| S | **Total tax benefits** = P + Q + R | **$–** | **$–** | **$247,250** | Assumes no other Canadian Source income or gains. |
| T | **Total Tax Net of Potential (Tax Benefit)** = M – S | **$94,017** | **$–** | **$(247,250)** | Positive number in column 1 represents a cost. Negative number in column 3 indicates a credit. |

***1.** Canadian capital gain is zero because donor elected to dispose at ACB using subsection 118.1(6) election.

***2.** Donation to Canadian recipient shelters only Canadian source income for U.S. tax purposes.

Tax rates are as of 2017

# Case Study 2: Camp on the Bay

Donation of a conservation easement, and subsequent disposition of the protected property

Dr. Mitchell Barton and his two business partners in a Milwaukee medical supply company acquired the 160-acre Camp on the Bay in 1990 for $600,000 as a hunting camp and corporate retreat. Each partner invested $200,000. They brought their clients, friends, and family members to Camp on the Bay to enjoy birding, fishing, swimming, and duck hunting. In 2009, Dr. Barton bought out his partners for $900,000 so he is now the sole owner, and his adjusted cost base is $1.1 million.

Dr. Barton and his family use the Camp occasionally, while leasing most of the property to Go Outside, a U.S. nonprofit that introduces youth to the outdoors, and hunting, in particular. A conservation organization called Protect Ontario Wetlands (POW) has been conducting annual bird surveys at Camp on the Bay. The surveys reveal the property has some of Ontario's best migratory bird habitat located on private land. Accordingly, the Camp is a high priority for conservation. Dr. Barton and Fred Meeker, the Executive Director of POW, have been discussing the future of the Camp and how to conserve it.

With retirement on the horizon, Dr. Barton and his business partners decided to sell their medical supply business. Next year, Dr. Barton will receive $2 million from the sale of the business. Dr. Barton and his accountant have been considering various possible tax deductions to reduce the U.S. tax he will owe on this sale. Dr. Barton considered transferring ownership of Camp on the Bay to Go Outside because it is a U.S. charity, but that gift would result in substantial Canadian capital gains taxes, as would moving ownership into a trust.

Instead, POW and Dr. Barton are working on a conservation easement agreement that he will donate to a U.S. prescribed donee next year in a transaction that will be tax deductible in the U.S. The conservation easement prohibits activities that could harm the wetlands, shoreline, and woodland habitat. After the easement is in place no agricultural, residential, or commercial development will be allowed. The existing buildings can be maintained and used for recreation, education, and other compatible activities, but may not be expanded.

The appraisal of the conservation easement indicates the current fair market value of Camp on the Bay is $2 million, based in part on the zoning which allows the property to be divided into four lots, all with waterfront. The easement restrictions will reduce the value of the property by $600,000, to $1.4 million. At some point in the future Dr. Barton will transfer the protected property to Go Outside or into a trust. In the meanwhile, that organization can continue using the Camp as it has in the past.

### *Understanding the case study 2 calculations*

- *The first calculation column shows the tax liability associated with a non-sale taxable transfer, for example, if Dr. Barton transferred title to Camp on the Bay into a trust or corporation, or to Go Outside, a U.S. charity. Such a transfer would be a taxable event in Canada.*
- *The second calculation column illustrates how donating a conservation easement to a Canadian recipient, such as Protect Ontario Wetlands, would reduce the capital gains taxes on a future transfer by reducing the market value of the property and providing a donation credit against the tax on the future transfer. Capital gains on the conservation easement gift would be eliminated by using the subsection 118.1(6) election (page 23). However, Dr. Barton's gift would not be an eligible deduction on his U.S. tax return.*
- *The third calculation column illustrates how donating the conservation easement to a U.S. prescribed donee would produce substantial U.S. tax savings in the year of the gift but no reduction in future Canadian tax on the later transfer. The tax benefits are shown at the bottom of the column as a credit.*

**Note:** In the second and third calculation columns the percentage of the adjusted cost base assigned to the conservation easement gift (row E) matches the percentage by which the fair market value is reduced when there is a conservation easement on the property (row C).

All amounts in U.S. dollars



| | Case Study 2 Calculations | Non-sale taxable disposition | Taxable disposition of property after donation of a conservation easement to Canadian land trust | Taxable disposition of property after donation of a conservation easement to prescribed donee | Notes |
|---|---|---|---|---|---|
| | **Disposition terms** | | | | |
| A | Appraised value of property | $2,000,000 | $2,000,000 | $2,000,000 | |
| B | Appraised value of conservation easement | | $600,000 | $600,000 | |
| C | Value of property after conservation easement = A – B | | $1,400,000 | $1,400,000 | |
| D | Closing costs @ 3% | $60,000 | $60,000 | $60,000 | |
| | **Taxes on Disposition** | | | | |
| E | Deemed proceeds | $2,000,000 | $1,400,000 | $1,400,000 | |
| F | Adjusted cost base | $1,100,000 | $770,000 | $770,000 | Pro rata portion of adjusted cost base. |
| G | Capital gain for Canadian tax purposes = E – D – F | $840,000 | $570,000 | $570,000 | |
| H | Canadian federal capital gains tax = G x 50% x landowner's Canadian rate (up to 33%) | $138,600 | $94,050 | $94,050 | Canada taxes 50% of capital gains at rate determined by the owners' Canadian income, including 50% of capital gains. |
| I | Canadian federal surtax = H x basic federal tax (48%) | $66,528 | $45,144 | $45,144 | Federal tax on amount of basic federal tax, in place of provincial tax |
| J | Canadian donation credits | $– | $(139,194) | $– | |
| K | **Total Canadian taxes** = H + I + J | **$205,128** | **$–** | **$139,194** | |
| L | U.S. gift tax = A x U.S. gift tax rate (up to 40%) | $743,200 | $743,200 | $743,200 | Assumes use of one annual gift tax exemption of $14,000. |
| M | Gift tax credit (unified lifetime credit) | $(743,200) | $(743,200) | $(743,200) | |
| N | U.S. income tax | $– | $– | $– | |
| O | **Total U.S. tax** = L + M + N | $– | $– | $– | |
| P | **Total Canadian and U.S. taxes** = K + O | **$205,128** | **$–** | **$139,194** | |
| | **Potential Tax benefits** | | | | |
| Q | Charitable gift portion – Canadian Tax | $– | $330,000 | $– | Donor could elect a higher disposition value if he had Canadian income to offset. This value is converted to a donation credit in Canada. |
| R | Charitable gift portion – U.S. tax = B | $– | $– | $600,000 | Appraised value of the conservation easement is the value of a charitable gift in the U.S. |
| S | Potential Canadian income tax savings | | ***1** | ***1** | Assumes no other Canadian source income or gains. |
| T | Potential U.S. federal income tax savings = R x U.S. federal income tax rate (39.6%) | $– | $– | $237,600 | |
| U | Potential state tax savings (WI) = R x state tax rate (7.65%) | $– | $– | $45,900 | |
| V | **Total tax benefits** = S + T + U | **$–** | **$–** | **$283,500** | Assumes no other Canadian source income or gains. |
| W | **Total tax net of potential tax benefit** = P – V | **$205,128** | **$–** | **$(144,306)** | Positive number in column 1 represents a cost. Negative number in column 3 indicates a credit. |

***1.** Donation to Canadian recipient shelters only Canadian source income for U.S. tax purposes.

# Case Study 3: The Sisters

Split-receipt donation/bargain sale example

Save Our Unspoiled Lakes (SOUL), an Ontario charity, has raised close to $1 million to protect the lakes in the watershed of the Sandy River. SOUL's top priority for acquisition is a 1600-acre tract known locally as "The Sisters" because it contains five lakes – Rose, Ruby, Pearl, Jewel, and Lily Lakes. The Koski family from Cedar Rapids, Iowa, has owned The Sisters since the 1920s. The Sisters is pristine except for a cabin compound at Lily Lake which has fallen into serious disrepair since eight cousins inherited the property.

A local real estate agent informed Jessica Jackson, SOUL's executive director, that the Koskis were going to put The Sisters on the market because the cousins cannot agree on the future of the property. Four of them would like to conserve the property, but they don't have the funds to buy out their relatives. The other four are eager to sell in order to recoup the Canadian capital gains taxes paid by the estate when they inherited the property in 1985, which was appraised then at $600,000. All eight are motivated to find a solution that is acceptable to everyone. The current appraised value is $960,000.

SOUL couldn't afford to spend all its capital on one property, no matter its priority for acquisition. The board is, however, determined to do its best to acquire The Sisters to prevent both logging of the intact forest and lakefront development. The directors asked Jessica to contact Karen Koski, the cousin who is most interested in conservation, and propose a "split-receipt" transaction. In the U.S. this type of purchase would be called a "bargain sale." Under the proposed terms, SOUL would pay $640,000 for the property, if the owners would donate the balance --$320,000 -- of the appraised value.

Karen discussed the idea with her cousins and they conferred with their U.S. and Canadian tax and legal advisors. All the cousins can use U.S. tax deductions. Their Canadian accountant suggested that SOUL and the Koski family work with a U.S. prescribed donee, so that the $320,000 gift of land value would be tax deductible in the U.S.

SOUL partners with a U.S. prescribed donee to successfully structure the split-receipt transaction on the proposed terms. The prescribed donee will purchase The Sisters and SOUL will manage the property. The cousins will receive a cash payment of $640,000, on which they will pay Canadian capital gains tax. The $320,000 value of the donation of land will be an eligible charitable contribution in the U.S.

### *Understanding the case study 3 calculations*

*The calculations accompanying this case study show the financial impact of U.S. taxpayers selling their Canadian property via a split-receipt transaction. All the figures are for the entire transaction. Each of the eight cousins would obtain 1/8th of the tax benefit and proceeds.*

- *The first calculation column calculates the tax liability associated with an outright sale of the property. In order to determine the Koskis' actual net proceeds from a sale on the open market, they will have to subtract any other selling costs from the sales price (for example, the real estate commission, provincial transfer tax).*
- *The second calculation column illustrates how selling The Sisters directly to SOUL at a discount reduces the Canadian and U.S. capital gains taxes because the sale price, and the gain, is reduced. The Koskis are taxed in both countries on the cash portion of the sale. The net tax consequences of the cash sale portion are the same in columns two and three.*
- *The third calculation column shows the potential tax outcome of the Koskis' sale to a U.S. prescribed donee. The value of the donated land could produce a U.S. tax benefit, which creates the credit, shown in parentheses. That credit further improves the bottom line of the transaction.*

**Note:** In the second and third calculation columns the decreased amount of the adjusted cost base (row E) shown for the split-receipt transaction maintains the ratio between the appraised value (row A) and the full adjusted cost base (row E), shown in calculation column one.

All amounts in U.S. dollars

| | Case Study 3 Calculations | Taxable sale disposition | Disposition at a discounted price and balance donated to a Canadian Land Trust | Disposition at a discounted price and balance donated to U.S. prescribed donee | Notes |
|---|---|---|---|---|---|
| | **Disposition terms** | | | | |
| A | Appraised value of the property | $960,000 | $960,000 | $960,000 | |
| B | Selling price | $960,000 | $640,000 | $640,000 | |
| C | Closing costs @ 3% | $28,800 | $28,800 | $28,800 | |
| | **Taxes on disposition** | | | | |
| D | Adjusted cost base | $600,000 | $400,000 | $400,000 | Pro rata portion of adjusted cost base. |
| E | Capital gain = B – C – D | $331,200 | $211,200 | $211,200 | |
| F | Canadian federal capital gains tax = E x 50% x landowner's CDN rate (33%) | $54,648 | $34,848 | $34,848 | Canada taxes 50% of capital gains at rate determined by the owners' Canadian income, including 50% of capital gains. |
| G | Canadian federal capital gains tax = E x 50% x landowner's Canadian rate (up to 33%)) | $26,231 | $16,727 | $16,727 | Canadian federal tax on amount of basic federal tax, in place of provincial tax |
| H | Donation credit | $– | $(51,575) | $– | Charitable gift portion of the disposition to a Canadian charity offsets Canadian tax on taxable portion of the disposition. |
| I | **Total Canadian taxes = F + G + H** | $80,879 | $– | $51,575 | |
| J | U.S. gift tax = A – B (less exclusions) x U.S. gift tax rate (up to 40%) | | $92,000 | $92,000 | Assumes use of one annual gift tax exemption of $14,000 |
| K | Gift tax credit (unified lifetime credit) | | $(92,000) | $(92,000) | |
| L | U.S. federal income tax = E x U.S. federal income tax rate (20%) | $66,240 | $42,240 | $42,240 | |
| M | U.S. state income tax = E x U.S. state income tax rate ( 8.98%) | $29,742 | $18,966 | $18,966 | |
| N | U.S. foreign tax credit | $(80,879) | $– | $(51,575) | |
| O | Total U.S. taxes = J+ K + L + M + N | $15,103 | $61,206 | $9,631 | |
| P | **Total Canadian and U.S. taxes = I + O** | **$95,982** | **$61,206** | **$61,206** | |
| | **Potential tax benefits** | | | | |
| Q | Charitable gift portion - Canadian Tax | $– | $200,000 | $– | The portion of the adjusted cost base that is gifted is the Canadian charitable gift portion. Donor could elect a higher disposition value if she had Canadian income to offset using the subsection 118.1(6) election if she had other Canadian income to offset. |
| R | Charitable gift portion - U.S. tax = A – B | $– | $– | $320,000 | The difference between the appraised value and the selling price is the value of a charitable gift in the U.S. |
| S | Potential Canadian income tax savings | $– | ***1** | $– | |
| T | Potential U.S. federal income tax savings = R x U.S. federal tax rate (39.6%) | $– | $– | $126,720 | |
| U | Potential state tax savings (IA) = R x state tax rate (8.98%) | $– | $– | $28,736 | |
| V | **Total Tax benefits = S + T + U** | **$–** | **$–** | **$155,456** | |
| W | **Total income tax net of potential tax benefit = P – V** | **$95,982** | **$61,206** | **$(94,250)** | Positive number in columns 1 and 2 represent a cost. Negative number in column 3 indicates a credit. |
| X | **Net cash in = B – C – P + V** | **$835,218** | **$549,994** | **$705,450** | |

***1.** Donation to Canadian recipient shelters only Canadian source income for U.S. tax purposes.

# Case Study 4: Loon Lodge

Ecological Gift of fee simple title of a portion of a property and subsequent transfer of the remainder

The Schneider family has a long history in Ontario, dating back to the late 1800s when Ralph Schneider's great-grandfather purchased approximately 250 acres of lakefront land with plans to establish a resort like the ones in the Adirondack Mountains of New York. Although Loon Lodge was not a commercial success, it has been the focus of the family's summers ever since.

Ralph and his wife Barbara are both 82-years-old, and live in Washington, DC, where Mr. Schneider had a long career in a federal agency. They have five adult children and many grandchildren, all of whom spend a portion of the year at Loon Lodge. Over the years, the Schneiders have spent $280,000 on improvements to make the building suitable for year-round use, anticipating that the family would enjoy it for generations to come.

When Mr. and Mrs. Schneider inherited the property in 1971 it was valued at $60,000. A current market analysis indicates that the fair market value is $1.3 million.

The area around Loon Lodge has been changing rapidly as owners of large lakefront parcels pass away and their heirs either divide the properties amongst themselves or sell. Buyers of these tracts are building expansive vacation homes close to the shore, often surrounded by lawn. The loss of forest and undeveloped shoreline has been very disturbing to the Schneider family.

Mr. and Mrs. Schneider want to keep the property in the family and protect it from development. At a summer workshop for American landowners hosted by the Many Rivers Conservancy, they learned about the Canadian capital gains consequences of transferring their property to their heirs or leaving it in their wills. They are worried their estate is not sizable enough to cover the capital gains tax liability, property taxes, ongoing maintenance of the lodge, and other expenses. Their current combined income is $80,000 per year.

Subsequent conversations with the land securement staff at Many Rivers Conservancy convinced the Schneiders that donating the most ecologically-significant acreage around Loon Lodge to the Conservancy through the federal Ecological Gifts Program, administered by Environment and Climate Change Canada, could help them achieve their conservation and financial goals. The Conservancy is a certified Ecological Gifts recipient.

The conservation lands comprise 220 acres with a fair market value of $400,000. Donating those lands would reduce the market value of the remaining property by a corresponding amount and provide the Schneiders with a Canadian tax credit, resulting from making an Ecological Gift that could eliminate the capital gains taxes on the subsequent transfer to their heirs.

### *Understanding the case study 4 calculations*

*The calculations accompanying this case study compare the tax consequences of the Schneiders transferring the entire Loon Lodge property to their heirs at its full appraised value versus the outcome of a similar transfer after they have conserved a portion of it with a donation of the 220 undeveloped acres to Many Rivers Conservancy through the Ecological Gifts Program (EGP).*

*In this case study the owners are donating fee simple title of a portion of the 250 acres to the Many Rivers Conservancy through the Ecological Gifts Program, however they could choose to donate a conservation easement instead and the calculation process would be comparable.*

- *The first calculation column shows the approximate amount of Canadian capital gains taxes that would be due if the Schneiders transferred Loon Lodge and the entire 250 acres to their heirs, without first conserving any of the property.*
- *The second calculation column illustrates the immediate tax consequences of the donation of 220 acres with the highest ecological value to the Many Rivers Conservancy through the Ecological Gifts Program. There is no tax on capital gains on a donation certified as an Ecological Gift. There are no U.S. tax benefits associated with this gift, but that is acceptable to the owners because they have relatively low U.S. income, and the elimination of taxes on Canadian capital gains is a more significant issue for them. Their gift of the 220 acres also produces a tax credit which shows up in calculation column three.*
- *The third calculation column demonstrates how the Ecological Gift makes the Schneiders' subsequent transfer of the remaining 30 acres and the Lodge itself more financially feasible given their financial situation. The Schneiders would have a Canadian tax credit from the Ecological Gift, illustrated in calculation column two which they would use to offset the Canadian capital gain tax that would otherwise be incurred when they transfer the remainder of the property to their heirs. There is a remaining Canadian tax credit after the disposition of $54,424. The tax credit can be used for up to 10 years after the year of the Ecological Gift.*

**Note:** Only Canadian environmental charities and municipal governments approved by the federal Minister of the Environment and Climate Change, as well as the federal and provincial governments in Canada, are eligible Ecological Gift recipients. *Therefore, prescribed donees cannot participate in the program.* Accordingly, the Ecological Gifts Program is generally not suitable for landowners who are seeking a U.S. tax benefit. The landowners in this scenario have a relatively low level of U.S. income and property that is expensive and highly appreciated, so they are excellent candidates to make Ecological Gift from a tax perspective.

All amounts in U.S. dollars

| | Case Study 4 Calculations | Non-sale taxable disposition | Donation of land to an eligible recipient under Ecological Gifts Program | Non-sale taxable disposition of remaining property within 10 years | Notes |
|---|---|---|---|---|---|
| | **Disposition Terms** | | | | |
| A | Appraised value of the property | $1,300,000 | $400,000 | $900,000 | |
| B | Closing costs @ 3% | $39,000 | $12,000 | $27,000 | |
| | **Taxes on Disposition** | | | | |
| C | Deemed proceeds | $1,300,000 | $400,000 | $900,000 | |
| D | Adjusted cost basis | $340,000 | $104,615 | $235,385 | Pro rata portion of adjusted cost base |
| E | Capital gain (if any) = C – B – D | $921,000 | $ – | $637,615 | Canadian capital gains are eliminated on gifts made through the Ecological Gifts Program. |
| F | Canadian federal capital gains tax = E x 50% x landowner's Canadian rate (up to 33%) | $151,965 | $ – | $95,227 | Canada taxes 50% of capital gains at rate determined by the owners' Canadian income, including 50% of capital gains. |
| G | Canadian federal surtax = F x basic federal tax rate (48%) | $72,943 | $ – | $45,709 | Canadian federal tax on amount of basic federal tax, in place of provincial tax. |
| H | Canadian donation credit (from Ecological Gift) | $ – | $(195,360) | $(140,936) | A Canadian tax credit generated as a result of the donation (Line Q) is available to offset Canadian tax on the taxable transfer of the remaining (or other) property for up to 10 years. |
| I | **Total Canadian taxes** = F + G + H | $224,908 | $ – | $ – | |
| K | U.S. gift tax = C x U.S. gift tax rate (up to 40%) | $463,200 | $119,200 | $344,000 | Assumes use of one gift tax exemption of $14,000. |
| L | Gift tax credit (unified lifetime credit) | $(463,200) | $(119,200) | $(344,000) | |
| M | **Total U.S. taxes** = K + L | $ – | $ – | $ – | |
| N | **Total Canadian and U.S. taxes** = I + M | $224,908 | $ – | $ – | |
| | **Potential Tax Benefits** | | | | |
| O | Charitable gift portion – Canadian tax = A | $ – | $400,000 | $ – | Appraised value is the value of a charitable gift in Canada. |
| P | Charitable gift portion – U.S. tax = A | $ – | $– | $ – | |
| Q | Canadian donation credit available in future = O x Canadian federal top marginal tax rate (48.84%) | $ – | $195,360 | original credit of $195,360 - credit used of $140,936 in row H = $54,424 remaining Canadian donation credit | A portion of the Canadian tax credit from the Ecological Gift is used on the later transfer. The balance of the credit can be used for up to 10 years from the date of the Ecological Gift. |
| R | Potential US federal income tax savings = P x U.S. federal income tax rate (39.6%) | $ – | $ – | $ – | |
| S | Potential state tax savings (DC) = P x state tax rate (8.95%) | $ – | $ – | $ – | |
| T | **Total tax benefits** = Q + R + S | $ – | $195,360 | $54,424 | |
| U | **Total tax net of potential tax Or (benefit)** = N – T | **$224,908** | **$(195,360)** | **$(54,424)** | Positive number in column 1 represents a cost. Negative number in columns 2 and 3 indicate a credit. |

# Notes

*Photo: Toby J. Thorne*

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