



Creating a private foundation

Private philanthropy has been an integral part of Canada's legacy to the charitable community. A philanthropist who wishes to strategically organize his or her charitable giving has many options. This article explores one of them: the private foundation.

What is a charitable foundation?

A charitable foundation is an entity that is constituted and operated exclusively for charitable purposes. It may be created by trust or incorporation. A charitable foundation generally fulfills its charitable purposes through the disbursement of its assets to other qualified donees, which include other registered charities.

In general, a qualified donee includes:

- registered Canadian charities, registered Canadian amateur athletic associations;
- most Canadian universities and colleges;
- United Nations or a UN agency;
- some foreign universities, foreign charitable organizations to which the Government of Canada has made gifts to during the charity's current taxation year or in the 12 months preceding the charity's current taxation year;
- Canadian municipalities;
- the government of Canada;
- the government of a Canadian province; and
- a municipal or public body performing a function of government in Canada.

What is a private foundation?

A private foundation is a philanthropic vehicle that can provide great flexibility for charitable giving by you, your family, related corporate entities and any unrelated donor. Often, private foundations are created to promote family philanthropy, and therefore are commonly referred to as family foundations.

Registered charities that are designated as private foundations are charitable foundations, in which:

- the majority of the directors or trustees do not deal at arm's length with each other or with the foundation's principal contributor(s); or
- a contributor to the foundation controls that foundation.

The designation of a charitable foundation as a private foundation does not preclude it from carrying out some of the charitable activities itself. Private foundations however, generally function as repositories and managers of funds. For the most part, the foundation's funds are generally granted to charitable organizations that carry on the charitable activities.

What are advantages of the private foundation?

The private foundation provides flexibility for donors wishing to pursue their philanthropic goals.

Of the three types of registered charities (charitable organization, public foundation and private foundation), a private foundation is most suitable for planned giving, mainly because it can be controlled by the donor and the donor's family. The donor or persons related to the donor are permitted to be a trustees or directors of a private foundation. As a result, they remain in a position to influence or control several aspects of the foundation's operations, including decisions on:

- investment of the donated assets;
- distribution of income earned by the foundation; and
- grants made by the foundation.

The donor's creation of the foundation means that the foundation can be named for the donor or the donor's family. Equally, an entirely unrelated name can be used. As with other registered charities, a private foundation can provide a philanthropic legacy that survives the founder's death.

Many private foundations are founded to coincide with a significant event in the founder's life, such as the sale of a business that generates significant cash proceeds.

So, how do you get there?

To be a registered charitable foundation, the entity must apply for and be granted registered charity status by the Canada Revenue Agency (CRA). This involves crafting the constituting documents of the foundation and other governance documents, such as by-laws, and then making an application to the Charities Directorate Division of the CRA on the basis that the foundation's purposes are completely charitable in nature. What is considered charitable in law is generally well established. Essentially, the charity must provide broad public benefit rather than benefiting a few individuals or a closely related group.

Generally, the constituting documents of a charitable foundation are structured to provide broad but exclusively charitable objectives, such as "to financially support organizations that are qualified donees." However, objectives can be stated more specifically. From the CRA's perspective, a charitable foundation meets the requirements of operating exclusively for charitable purposes if it disburses funds to other qualified donees.

What are the costs and operating requirements?

For a private foundation, initial set-up entails legal and other professional advisory costs, among others. Ongoing costs include accounting (to audit the financial statements and to prepare annual tax filings) and investment management costs for the foundation's investment portfolio. Generally, most charitable foundations are constituted to forbid compensation to the trustees or directors for services in that capacity.

Once a private foundation is established, administrative and governance requirements must be satisfied, such as holding board meetings, maintaining adequate books and records, and issuing donation receipts in accordance with the requirements of the Income Tax Act (Canada) and Income Tax Regulations. As well, provincial statutes might govern the charity's activities.

Despite the "private" in "private foundation," much of the information relating to the foundation, its financial position and its activities is subject to public disclosure and scrutiny, because registered charities are considered to be quasi-public entities.

How do you fund and operate a private foundation?

Funding generally comes from a single source, such as an individual or family unit or even by businesses related to the founder(s) of the foundation. For a contribution to qualify as a gift for tax receipting purposes, it must be a transfer of property by the donor for which no consideration is expected. Therefore, contributions generally are made without conditions. However, gifts to a private foundation can be structured with conditions being imposed by the donor. For instance, the donor can attach a condition to the gift which restricts the foundation from spending the capital of the gift for a period of time or one that designates the funds for a specific charitable program that is being operated by the foundation. Where the foundation's capital is accumulated in perpetuity or for an extended period of time as a result of a condition imposed by a donor, the gift is considered an endowment or restricted funds respectively of the foundation. During the period of the endowment or the restriction, the foundation still has access to the income earned on the endowed funds or restricted funds.

The operations of a private foundation are managed by directors or trustees that generally do not deal with each other at arm's length. The trustees and directors may manage the investments themselves and/or delegate the responsibility to an investment management firm, depending on the investment powers that are provided for in the foundation's constituting documents.

What is the tax treatment of gifts made by a donor to a private foundation?

Cash gifts and gifts of property to a private foundation are eligible to be tax-receipted for the property's fair value at the time of the gift.¹

A donor can claim a donation tax credit in the case of an individual, or a donation tax deduction in the case of a corporation, to reduce personal or corporate tax liabilities, subject to annual net income limitations.

Recently enacted tax legislation allows a donor a special donation incentive when publicly traded marketable securities that are listed on a designated stock exchange (referred to as "securities") are donated to a private foundation. For donations made after March 18, 2007, no portion of the capital gain that arises on the donation of these securities is included in the donor's income.²

If the donated property is a "nonqualifying security" (such as shares of a private company that the donor owns), there may be restrictions on issuing tax receipts for the donation. Therefore, to ensure that the donor can claim such a gift as a donation for tax purposes, care is required in structuring the donation of private company shares.

1. The amount of the gift that is eligible to be tax-receipted is the fair value of the property donated less the fair value of any advantage or benefit conferred on the donor or persons related to the donor.

2. Certain provincial tax authorities, including Alberta Finance, have not stated whether or not they intend to parallel the proposed federal treatment for gifts of qualifying publicly listed securities to private foundations after March 18, 2007, but that provincial tax authorities are generally expected to provide parallel capital gains tax relief.

What does it mean to be a Canadian registered charity that is designated as a private foundation?

Being a Canadian registered charity means, among other things, that the charity is granted tax-receiving privileges for donations it receives.

A charity's responsibilities and governance continue even after registered status is granted. To maintain registered status, the charity must abide by a number of tax rules. One requirement is to spend a minimum amount each year on its own charitable activities or by way of gifts to qualified donees. The minimum disbursement requirements exist to oblige the charity to use its funds and tax-assisted donations to help others in accordance with its charitable purposes.

In addition, a registered charity that is designated as a private foundation is subject to a number of restrictions, some of which are designed to prevent

private benefit. These restrictions include the prohibition from:

- carrying on any business;
- making a gift to a recipient that is not a qualified donee; or
- incurring debt except for certain purposes.

As well, new restrictions can limit a private foundation's shareholdings in corporations, in certain circumstances, and increase reporting of its shareholdings and that of persons not dealing at arm's length with the private foundation.

Closing considerations

Charitable giving is a win-win opportunity for both donor and charity. Often, creating and shaping charitable giving through one's private foundation is challenging and may give you considerable flexibility when it comes to fulfilling your philanthropic goals. Planning in advance — and well — can make the philanthropic journey rewarding.

Who to call

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There are two PwC publications that deal with charities.

Lending a hand: Tax Guide for Charities is aimed at the charities themselves, while ***Reaching out: Charitable Giving Guide for Donors*** is aimed at donors. Both are available in hard copy or on our website at www.pwc.com/ca/taxpublications.