Donation of Private Company Shares

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The COVID-19 pandemic heavily impacted the charitable sector. According to Imagine Canada, at the height of the pandemic, charities saw a 43 per cent decline in donations and income from other sources. Many of these charities continue to struggle financially, while the demand for service provision continues to grow. This article provides considerations for donating private company shares as a way to support Canada's charitable sector.

While the tax benefit of making a charitable gift may not be the sole motivator when deciding to help your community, Canada has a generous tax regime providing a tax credit based on the eligible amount of the gift made to a qualified donee. These charitable gifts are donated to charities, foundations and Donor Advised Funds ("DAF"), and they also provide a taxable benefit to the donor.

There are many ways to make a charitable gift. The most popular means are cash and gifts in-kind of publicly-traded securities. Additional tax incentives include eliminating capital gains that are realized on the value of the property at the time of the donation. For more information, please ask your BMO financial professional for a copy of our publication, *Donating Appreciated Securities*, which describes the income tax benefits that may arise when publicly-traded securities are donated to charities.

Gifts of "non-qualifying securities"

Many small business owners wonder if the same tax benefits may be received if they were to make a gift of private company shares of a Canadian-Controlled Private Corporation ("CCPC"). Private company shares are viewed very differently by the Canadian tax system because there is the potential to manipulate their value when they are transacted between non-arm's length parties. This kind of manipulation could otherwise result in an inflated donation credit, thus donations of private company shares become ineligible for the elimination of capital gains, as is provided for publicly-traded securities. The charitable donation tax credit for certain "non-qualifying securities" cannot be claimed unless or until specific criteria are met. If these criteria are met, then donating private company shares may still result in favourable tax consequences to the donor in a number of situations.

How to donate private company shares

- Shares must be valued by a qualified business valuator. One option is to donate fixed value preferred shares that have been assessed a value by the process of administering an estate freeze.
- In certain cases, the shares must be disposed before the donor is able to receive the donation tax credit. As such, the CCPC needs available cash for the redemption. There are legal fees associated with the redemption and cancellation of the shares.
- Due to the complexity, not all charities will accept donations of private company shares. However, it may be possible to gift shares of a private company to a public foundation with a Donor Advised Funds program. For example, in certain circumstances, Gift Funds Canada, the charitable partner of the BMO Charitable Giving Program, is able to accept donations of private company shares for the creation of a DAF, provided the shares have been professionally valued and are immediately liquidated. The cash proceeds are subsequently invested, and the donor makes grants to qualified donees from their DAF in due course.

Proceed with caution

Private company shares will typically be considered "non-qualifying securities" in the Income Tax Act when gifted. Additional property which is captured in this definition includes other obligations and forms of security between non-arm's length parties, including promissory notes. The value of the gift is nil (and thus, no tax credit is awarded), unless or until the shares which are the subject of the gift either cease to be a "non-qualifying security", or the gift meets the definition of an "excepted gift" under the Income Tax Act.

1. Gift ceases to be a "non-qualifying security"

The charitable donation tax receipt can be issued at the time when a private company share ceases to be a non-qualifying security within 60 months of when a gift is made. It can also be issued if the charity disposes of the non-qualifying security within 60 months of a gift being made (considering it is not another non-qualifying security). The value of the donation tax credit will be the lesser of the value at the time the gift is made and at the time the share is disposed or ceases to be a "non-qualifying security".

2. Gift qualifies as an "excepted gift"

An "excepted gift" is a gift of a "non-qualifying security" to a charity that is not a private foundation and the donor (or their estate, if the donation is being made from their estate) is at arm's length with the charity. If the charity is a public foundation, then the donor must also be at arm's length with the foundations' directors, trustees, officers, and other officials.

3. Other rules to keep in mind

There are specific anti-avoidance rules in the Income Tax Act relating to gifts of "non-qualifying securities" that either reduce or disqualify the donation tax credit in various circumstances, such as when indirect gifts are made. If an advantage is received by a taxpayer in exchange for the gift, the eligible amount of the gift may be reduced by the amount of the advantage.

Seek advice

Although there are significant benefits that can be achieved by donating private company shares to charity, there are many tax considerations that require the advice of an experienced accountant or tax advisor, to ensure your donation will qualify for a tax credit, and that the timing of the tax credit aligns with the tax consequences associated with making the donation itself. Considering the complexities of the tax legislation governing gifts of private company shares and other "non-qualifying securities", professional advice is paramount in designing and implementing your charitable giving strategies.

For more information, please speak with your BMO financial professional.

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