NATIONAL ROUND TABLE ON THE ENVIRONMENT AND THE ECONOMY
TABLE RONDE NATIONALE SUR L'ENVIRONNEMENT ET L'ÉCONOMIE

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Canada

ECO



# DONATIONS OF ECOLOGICALLY SENSITIVE LAND - REMOVING THE CAPITAL GAINS BARRIER

January 1995
*A paper prepared for the National Round Table on the Environment and the Economy*

## Introduction

This paper describes new incentives for the donation of ecologically sensitive land, including removing the capital gains tax from these donations. These measures will assist in increasing the protection of Canada's biodiversity. The proposed program has the virtue of being predictable, manageable and measurable. It is a critical element in encouraging a true partnership between the public and private sector in the acquisition and protection of ecologically sensitive lands.

Protection of Canada's biodiversity has long been a goal of the Canadian government. In the Throne Speech of 1970, the emerging Department of the Environment was envisaged *as being a department to be concerned with the environment and the husbanding of these renewable resources that are part of and dependent upon it, with a mandate for the protection of the biosphere.*(1) In fact, the Prime Minister's Office (PMO) of the time saw the department as being an ecosystem manager. (2) These were ambitious statements, and at various points the government has reinforced the need for an "ecosystem manager". In 1990, Canada's Green Plan announced a national objective of bringing the total protected spaces in Canada to 12% of the overall land mass.(3) The current government reiterated the importance of this objective in its "Red Book" (page 70).

Historically, the public sector has regarded public ownership as the best way to achieve protection of ecologically sensitive lands. As Marc Denhez put it,

> "If the protection of lands were considered essential, a way might be found to integrate those lands with the federal, provincial or municipal parks system. With the passage of time, other regulatory methods were introduced. The expansion of the network of protected lands, by implication, was assumed to be the responsibility of the public sector at the taxpayers' total expense: *when a given property was considered both vital and endangered, the assumption (among both public and private sector interests) was that its protection would depend upon public acquisition (by purchase or expropriation).(4) (italics mine)*

It is becoming increasingly difficult for Environment Canada to acquire or expropriate vital and endangered lands. Public sector spending has been slashed and departmental budgets have been radically reduced. The Department of the Environment experienced a 30 percent decrease in funds for the 95/96 operating year. At the same time, two other related forces are at work in our society.

The country's increasing population is placing greater pressures on the most heavily populated areas. Only 10.8% of Canada's lands are in private ownership, but this encompasses the area (mostly the southern strip running east and west) on which the vast majority of the population lives. The combination of urbanization and intense utilization of natural resources which is occurring in this region is jeopardizing biologically unique features of the Canadian landscape, as well as critical transportation links for migrating wildlife. Since much of the migrating wildlife that summers in the north is dependent on the southern parts of Canada in order to complete migration patterns, it is not enough to save the north (in order to meet our 12% preservation goal) and lose those ecologically sensitive areas in the south.

Second, development pressures and an elevated awareness of environmental issues has stimulated the founding of charitable organizations whose sole purpose in the preservation and stewardship of specific ecologically sensitive areas or certain types of ecologically sensitive land. This represents an emerging "private" sector which has few tools available to encourage potential donors to participate in the protection of key sensitive areas. This new market is lobbying government for a "partnership" with the private sector and for specific incentives to make donation of ecologically sensitive land more attractive.

There is no question that new, more creative approaches are needed to ensure the protection of ecologically sensitive land in heavily populated areas of Canada. If Canadians are to achieve the goal of sustainable development, we must influence public policy and market forces to create incentives to reach environmental, social and economic objectives in an integrated and coherent manner. Time is of the essence. Many of the ecologically key lands in this country will be lost to development or overuse within our lifetime.

## The Current Environment

There is no doubt that the integration of environmental and economic policies is gaining currency, both in terms of public opinion and government action. In July 1994, the Ministers of Environment and Finance announced the establishment of the Task Force on Economic Instruments and Disincentives to Sound Environmental Practices, consisting of business leaders, academics, environmentalists and government officials. The terms of reference for the Task Force asked it to identify, for consideration in the consultations leading up to the 1995 budget, workable options for the implementation of one or more market-based instruments, and to identify one or more barriers or disincentives to sound environmental practices. The Task Force made specific recommendations and highlighted areas for future work. The recommendations which related to land donations for conservation are contained in Appendix 1.

Fortunately, demographics and real estate market trends make this a good time to promote land donations. Much of the privately held land in Canada was purchased before 1960. Many of the purchasers have now reached the age when they must dispose of the land. Land holding costs have increased significantly over the last 15 years as municipalities increased property taxes - another incentive to dispose of property. The land may be sold, gifted to the next generation or donated. If the land is gifted, there is a deemed disposition and consequent capital gains tax. If the next generation is indifferent or there is no next generation, the option is not available. Donations are a viable alternative.

On February 27, 1995, the Minister of Finance announced the government's intention to take an extremely useful initial step in promoting land donations by amending the *Income Tax Act* to allow donors of ecologically sensitive land to municipalities and charities - the same deduction from net income (100%) that was then in existence only for donations to the Crown (budget excerpt contained in Appendix 2). In practice, this change will primarily affect donors with small capital gains (likely those who have owned the property for a short time). In such cases the tax credit could far outweigh capital gains tax payable. It is not expected, however, that the impact of this change will be large, since there are few donations of this type.

Currently, *the Income Tax Act* governs every donation made in this country. When property is donated, it is deemed to have been disposed of (or sold) at fair market value. If the property is not investment property that is, if it contains one's personal residence, then the resulting, deemed capital gains (the difference between current fair market value and the adjusted cost base) are not taxable. However, if the property was used to or intended to produce income, then the deemed capital gains become part of one's taxable income. Eligible benefactors (the Crown, municipalities and charitable institutions) can issue receipts for the fair market value of the lands donated. A tax credit is available based upon the receipt value times the donors marginal tax rate. A donor can make use of the tax receipt up to 100% of taxable income but can only carry forward any unused portion for up to six years after the donation. Some donors can offset 100% of their income taxes for a period of six years.

Unlike many donations that Canadians make, donations of land are larger in scale than other kinds and are sometimes out of proportion with the donor's income. This imbalance affects the attractiveness of the donation to the donor. An example will illustrate (see also Table 1). Suppose the owner of a piece of land bought for $100, 000 in 1971 decides to donate it to Ducks Unlimited. It now has a fair market value of $1,000,000. Generally speaking (because capital gains calculations do depend on improvements to the property, as well as some other factors), the donation of this land would result in a capital gain of $900,000. Since 75% of capital gains are taxable, $675,000 would used to calculate the tax payable ($675,000 x 52% = $350,000). The tax credit for this donation would be $1,000,000 x 52% = $520,000 (actual top marginal rates for 1995 range from 44.4% in the Northwest Territories to 54.2% in British Columbia). The donor then has $170,000 of "leftover" tax credit to offset taxes payable on other income ($520,000 - 350,000 = 170,000). The donor has up to six years to use up the credit. However, if the donor has low income the credit may be greater than taxes payable. Since the credit can only be applied to reduce taxes payable to zero (the government does not make cash payments for credits) some of the credit may be lost to low income donors.

Charities have another new tool to use for land protection, the conservation covenant or easement. Although the common law restrictive covenant does not work well, especially in regard to large land holdings, new conservation covenant or easement legislation has recently been passed in Nova Scotia, British Columbia and Ontario, is under active consideration in Saskatchewan, Manitoba and Prince Edward Island and not so active consideration in the other provinces. Such legislation eliminates certain common law problems and allows a land owner to donate an easement or covenant to certain entities (such as NCC or Ducks Unlimited). The land

Table 1

**Sample Tax Calculations**

| | | |
|---|---|---|
| Fair market value at time of donation (receipt) | | $1,000,000 |
| Original cost to owner | | 100,000 |
| Deemed capital gain | | $900,000 |
| | | |
| Capital gain eligible for taxation (75%) | $675,000 | |
| Tax payable on capital gain, assume 52% marginal tax rate | | $351,000 |
| Less tax credit on donation receipt x marginal tax rate | | 520,000 |
| | | ($169,000) |

If positive, this is tax payable
If negative, this is remaining tax credit available to offset tax payable on other income, for up to 6 years.

Using the Tax Credit

Use depends on the amount of other income. Consider two cases:

| | |
|---|---|
| If $50,000/year x 6 years | $300,000 |
| Tax payable at 26.6% tax rate | 79,800 |

Tax completely offset by credit. No taxes payable, but $90,200 credit (53%) is unused.

| | |
|---|---|
| If $80,000/year x 6 years | $480,000 |
| Tax payable at 35% tax rate | 168,000 |

Credit completely offsets tax. Ninety-nine percent of credit is used.

must be kept in its natural state but the donor may continue living on it. The down side from the owner's point of view is that the land has a lower market value because development opportunities are, in effect, eliminated. Thus the covenant or easement has a value and the donor has given up an interest in the land equal to such value. The result can be a deemed disposition and consequent capital gain. While the enabling legislation on covenants is provincial, tax consequences upon disposition are a federal matter. This is another area in which effective tax legislation must keep pace with social policy.

In spite of current provisions for land donations, covenants and easements, the government will likely continue to acquire conservation lands primarily by purchasing them at full market value. Furthermore as government spending is continuously slashed, less and less land will be purchased. Without a change, the goal of preserving 12% of our land mass, with representative biodiversities, will continue to elude the Canadian government.

## Proposed Changes

This paper has, so far, described the need for promoting donations of ecologically sensitive lands and the current corresponding program. In this section improvements to the program are proposed in three areas: capital gains, credit equity and land valuation.

Proposal 1: **Remove capital gains tax from donations of ecologically sensitive land to a maximum, capped amount and for a specific period of time. Re-evaluate regularly to assess effectiveness.**

Is the application of capital gains a barrier to donations? The short answer is: in some cases. It has been observed in a number of studies that donations of cultural property (e.g. art or archival material) are substantially more prevalent than donations of real estate. Part of the reason is that the *Income Tax Act* provides a distinct tax treatment to donations of "certified cultural property" and exempts them from capital gains tax.

From the land donor's point of view, even if they can use all of the available tax credit they could still be required to make a net payment. This happens (for cases when all of the tax credit is used) if the fair market value of the property is greater than three times the original cost (adjusted cost base)(See Appendix 3 for rationale). Here, the donor must make a payment to government in addition to forgoing profit from the sale of the land and future income from use of the land.

The Department of Finance expresses a number of concerns about removing the capital gains barrier, all of which have merit and deserve, for the financial health of the nation, to be addressed. There are essentially four: cost (both total and individual), predictability (of tax revenue), the appropriateness of tax policy subsidizing a large percentage of the cost of a donated asset, and a potential domino effect to other organizations.

The Department of Finance analyses the situation as follows. Either the owner of a piece of land pays capital gains tax upon disposition, or the tax is paid after the owner's death, when deemed disposition occurs. With this "pay me now or pay me later" approach, it can then be argued that the government would be subsidizing approximately 87% of the cost of a donation if capital gains tax is eliminated (52% tax credit plus 35% foregone capital gains tax). The further argument is that at that high cost it is more appropriate for the government to keep control of the process by initiating a new purchase program within the relevant Department. Apart from the fact that there is no indication that in the current economic climate such a program will be initiated, it can be argued that at 87% subsidy, it is still more cost-effective for a proposal such as the one brought forward in this paper to be implemented. The private sector organizations like NCC have the expertise, experience and infrastructure which governments would have to replicate, at least in part. Also government control can be exercised in many ways, including the criteria required to qualify lands, tax credit rules and land valuation procedures.

However it is important to examine the kind of logic implicit in this argument, as well as the actual decision-making process that a potential donor will use. For this an opinion was sought from KPMG Peat Marwick Thorne, Chartered Accountants. From their report...

> "It appears to us that the Department of Finance is comparing Scenarios one and three [contained in Appendix Five]. Accordingly, in estimating the tax subsidy involved in exempting the gain, they are giving up the tax that would be payable on a scale of the land ($35,100) plus giving a tax reduction due to the donation credit ($52,000), for a total of $87,000. This is how they arrive at a tax subsidy of 87% [Department of Finance calculations are contained in Appendix 5] of the $100,000 assumed value of the land.

> However, if a potential donor is trying to decide whether or not to donate the land (and will keep the land rather than sell it if it is not donated), the donor's concern is the tax cost or benefit of making the donation. In this case, it becomes relevant whether there is tax payable on the capital gain arising when the land is disposed of as a donation. If you compare Scenarios two and three, the donation credit is a constant and the amount at issue is the tax payable on the gain, i.e. $35,000. If the gain is taxable (Scenario Two), the tax payable on the gain reduces the value of the donation credit to the donor as well as the revenue cost of the donation credit to the government (net tax benefit or subsidy to the donor; ($16,900). However, if the gain is tax exempt (Scenario Three), the full amount of the donation credit of $52,000 is available to the donor to reduce tax otherwise payable on other income. Government revenues are reduced by a corresponding amount. Accordingly, in this situation it would appear that the true cost to the government of exempting the gain is $35,000.(5)

The total cost to the government of a land donation program depends on the number of people who choose to participate. No person or organization has tried to determine how many potential donors are waiting to donate land to the Crown and charities. However, Nature Conservancy Canada records on past donations indicate that "The land donations to the Conservancy over the last ten years have not exceeded $400,000 a year on average"(6). In addition, the NCC compiles information on ongoing projects within its own organization:

> "Currently, NCC is processing across Canada about 153 land projects, of which about 45 comprising some 123,000 acres are contemplated as donations or part donations. Of these we know that there are tax concerns with 15 comprising 21,000 acres and from experience, probably tax concerns with another six or so. Potential donors usually contact NCC in the first blush of enthusiasm and before talking to their lawyers or accountants. Often that ends it. Tax concerns can involve matters other than capital gains, but NCC believes that this, in most cases is the dominant concern and if it occurs in about half of the proposed land donations it is a significant factor."(7)

While a change in the *Income Tax Act* will increase the number of donations, the "target market of donors" (to look at it from the point of view of the charitable organizations) is limited in terms of numbers. It is unlikely to start a hemorrhage from the Federal Treasury. To control costs, Finance Canada could limit the number of donors that could access a capital gains exemption in any given year. With annual limits, predictions of the total cost to the government would be more accurate.

There are precedents for the use of access limits in other, innovative tax relief programs which were created to stimulate rapid development in certain targeted sectors of the economy. In any given year, companies wanting to make use of the program are handled on a "first come, first served" basis. When deductions up to a specific dollar limit have been allocated, all other companies in line must wait until the following year.

Finance Canada is also concerned that if the capital gains tax is eliminated donors would inflate the value of the land in order to maximize the tax credit. This has been a problem on occasion in the *Cultural Properties Act* exemption and is summarized in Appendix Five. Requirements for comprehensive, professional estimation of fair market value can provide protection against over-valuation. (See Proposal Three)

The Department of Finance has stated that:

> "It is unlikely that a capital gains exemption could be restricted to gifts of ecologically sensitive land. Extension to other property gifts (e.g., land of a food bank or a camp for disabled children) would increase the revenue cost of the measure." (8)

This measure serves a very specific purpose - to improve Canada's inventory of protected land up to the goal unanimously agreed to by an Act of Parliament. A sunset clause which eliminates the deduction when this goal is achieved, may further tie this initiative to the Act; however, the goal is clearly an environmental one, consistent with government policy. A domino effect to other kinds of charities would require a serious leap in logic, one which is unlikely on the part of Finance officials.

A number of general comments apply to the capital gains question. One participant at the NRTEE workshop, from the Greater Vancouver Regional District (GVRD), pointed out a conceptual problem. In his words, "You want the land, and you want the tax too. In the gift situation, the public ends up with the asset." He went on to add "If you change donation patterns in the short-term, you increase the likelihood of changing behaviour over the longer term." This participant went on to point out that the GVRD has an acquisition program in place and it is fully subscribed (it has purchases lined up) for the next five years. Another participant pointed out that, if the total cost is not great and is of benefit politically and to the environment, then perhaps it is still a useful policy to pursue. Most participants were pleased to see the full effect of the initiative in last year's budget - they hadn't realized it would have such a large impact on a donor's tax situation. However, they were left with concerns about the treatments of covenants and about doing more to achieve parliament's stated goal of 12% preservation by the year 2000. Most felt that a short-term change in capital gains would be very useful in reaching this goal.

It should be emphasized that by donating rather than selling, a donor will always be out of pocket, even with a capital gains exemption. Our donor from the earlier example stands to receive a tax credit of $520,000, but would receive $650,000 if the land were sold ($1,000,000 - $350,000 in capital gains tax). The capital gain very often has a large inflation component. In other words, in constant dollars there may be little or no gain. Finally, for the standard donated property, the donor has paid property taxes, utilities and the cost of maintenance. None of these costs are tax deductible or can be set off against the capital gain.

## Alternatives

It is useful to look at the range of alternatives for administering captial gains taxation on donations of ecologically sensitive land.

### 1. Do Nothing

This alternative assumes that the alteration to deductibility of donations included in the 1995 budget is the only change that will be made. The impact will be felt in cases of land that has not been held for a long time by the donor and the capital gains liability is small. In such cases that ability to deduct up to 100% of net income will far outweighcapital gains tax payable. It is not expected, however, that the impact of this change will be large. For the most part, the government will continue to acquire land at full market value. Furthermore, as government spending is continuously slashed, less and less land will be purchased. The goal of preserving 12% of our land mass, with representative biodiversities, will continue to elude the Canadian government.

2. Eliminate capital gains tax from donations of ecologically sensitive land.

This alternative means that anyone with an appropriate piece of land, giving it to a qualifying charitable organization could do so, without paying capital gains. It is potentially dangerous because no one has been able to estimate the number of potential donors who are awaiting this change. In the absence of such information, the effect of a change is completely unpredictable. In this case one could control the individual cost of a donation (through the qualifying regulations that are set in place), but could not control the total cost to the Treasury. In this time of budget cutting and fiscal restraint, it would be irresponsible of the Ministry of Finance to introduce a program, the effect of which cannot be anticipated.

3. Remove capital gains tax from donations of ecologically sensitive land to a maximum, capped amount and for a specific period of time. Re-evaluate regularly to assess its effectiveness.

This option is a logical compromise between the extremes of the first two alternatives. Donations are made more favourable to land owners, which will lead to more conservation of sensitive lands and greater preservation of Canada's biodiverstiy. Fiscal effects to government are monitored and managed. Cash flow to the federal treasury can be assessed via annual tax returns and the information used to fine tune the program by altering the ceilings on donations.

Proposal 2: **Make the tax credit program more equitable by using a flat rate or progressive tax credit and eliminating time limits on using credits.**

The current tax credit procedures create a regressive tax in which the wealthy receive a greater benefit than the poor (as illustrated in the example, Table 1). Should the government be providing a tax subsidy which benefits high income earners? If anything, the system should be progressive and reward low income earners more, since the loss of profits from the sale of lands is more significant to them.

The program is currently skewed in favour of the rich in two ways. First, since the tax credit is calculated on the basis of marginal tax rate, wealthy donors get a larger credit (equal to a greater portion of the receipt). Second, wealthy donors can use the entire credit since only they have income high enough to incur high taxes to offset. There are two corresponding changes which will make the tax credit procedures more equitable.

First, the tax credits from donations of ecologically sensitive lands can be made more equitable by using a flat rate to calculate the amount of the credit. To create a progressive system, the multiplier could be a constant minus the marginal tax rate.

In addition, to allow low income donors to use the entire credit, the time limit in claiming the credit should be eliminated. Donors could be required to use the credit immediately and in consecutive years so that the credit is processed expeditiously and not left for a discretionary application at some future time.

Proposal 3: **Assess land values on the basis of past transactions involving the property, plus two current valuations.**

The value assigned to the land is critical in determining the value of the tax credits. Although the ecological value of the land may not be reflected in the fair market value, this is the measure which is most convenient. In valuing donations, it is easier to find concrete indicators of the value of land (tax and mortgage assessments as well as sales of similar land) than of cultural properties. However, it is difficult to accept any single land assessment value. A potential solution might be to submit an historical record of financial activity on the property (including four or five consecutive tax assessments, any mortgages taken out and revenue received from activities on the land), in addition to two current real estate valuations so that Revenue Canada can judge them in context.

## Elements of an Effective Program

This section sets out some preliminary thoughts on the parameters of a pilot program. It is only meant to suggest that some creative programming can satisfy a number of constituent groups. During an initial trial period, the government will be able to assess the number of potential donors, examine the quality of land brought forward, check for possible abuses of the program, and most importantly, control the total cost of the program. This trial period will also give the organizations lobbying for change an opportunity to prove that removing the capital gains barrier is the significant tool they need in order to contribute to the 12% preservation goal.

| | |
|---|---|
| Purposes: | To achieve 12% protection of Canada's land mass by the year 2000. To maximize the quality of ecologically sensitive land preserved for the government dollars expended. To include the private sector in preserving ecologically sensitive land. |
| Timing and Evaluation: | A four year pilot program to be evaluated annually on the basis of actual dollars expended, quality of land acquired, ease of administration, organizations making use of the program, size of waiting list, etc. |
| Budget Allocation: | Between $15 and $30 million to a maximum of $100 million over the four year life of the program. |

## Conclusion

With current and anticipated budgetary constraints, the Government of Canada will need assistance in achieving the goal of 12% preservation of ecologically sensitive land. Private owners of such land need inducements to convince them to donate their land. It is time for some new and creative solutions to these two related problems. In the words of Marc Denhez, "There is far more than mathematical tinkering hanging in the balance: the question is who is going to show leadership for the attainment of Canada's environmental objectives" (8) Since the budget is the most important environmental document produced by any government, the time is right for the Minister of Finance to show this leadership and, in the process, draw the private sectors into the effort to preserve ecologically sensitive land in this country.

*Submitted by*: Karen Morgan, Robin Fraser and Jane Inch

**Notes**

1. Doern, G. Bruce and Conway, Thomas The Greening of Canada: Federal Institutions and Decisions. University of Toronto Press Toronto, 1994 page 17.

2. Ibid, page 18

3. Denhez, Marc You Can't Give It Away: Tax Aspects of Ecologically Sensitive Lands Canadian Wetlands Conservation Task Force, NRTEE, North American Wetlands Conservation Council Ottawa, 1992 page 2.

4. Ibid, page 1

5. Letter from Loreen Dunn, Senior Manager, National Tax, KPMG, to Karen Morgan, August 2, 1995

6. Letter from Robin Fraser, chair, Land Donations Task Force, The Nature Conservancy Canada to the Honourable Paul Martin, March 4, 1994.

7. Letter from Robin Fraser, Chair, Land Donations Task Force, The Nature Conservancy Canada to Karen Morgan, October 14, 1995

8. "Tax Assistance for Donations of Ecologically Sensitive Land; Notes for Discussion with Karen Morgan", July 12, 1994

9. Denhez, Marc "You Still Can't Give It Away" unpublished report, September, 1994.

## Appendix I

## EXERPT FROM THE FINAL REPORT OF THE TASK FORCE ON ECONOMIC INSTRUMENTS AND DISINCENTIVES TO SOUND ENVIRONMENTAL PRACTICES

November 1994
pages 20 and 21

*Conservation*

Parliament's commitment to preserve 12 per cent of Canada's representative land-based natural regions by the year 2000 requires a variety of alternatives to supplement the traditional government approach of purchase of land.

The current tax system treats donations to the Crown and third parties (i.e. municipalities or charitable institutions) differently in terms of the maximum amount that may be claimed for a donation tax credit or deduction in any year (see table). As well, donations of land may be subject to capital gains tax, payable by the donor.

| Donation to: | Deductible up to ______ per cent of net income | Capital gains tax payable? |
|---|---|---|
| | (per cent) | |
| Federal government | 100 | yes |
| Provincial government | 100 | yes |
| Municipalities | 20 | yes |
| Charitable institutions | 20 | yes |

These provisions in the current tax regime act as a disincentive to individuals who own ecologically sensitive land and/or conservation convenants[2], and who would otherwise donate the land and/or covenant to a charitable institution or to a municipality.

The Task Force agreed that there was scope for the federal government to encourage donations of ecologically sensitive land which will contribute towards this goal of conservation of biodiversity. The measures below would increase the tax benefits of such donations and provide and additional incentive for landowners to donate their ecologically sensitive land.

## Appendix 2

### EXERPT FROM FEDERAL BUDGET, 1995/1996

TAX MEASURES SUPPLEMENTARY INFORMATION

**Donations of Ecologically Sensitive Land**

The income tax system currently provides substantial assistance for donations of ecologically sensitive land to charities and government bodies. Individuals receive a federal tax credit of 17 per cent on the first $200 donated and 29 percent on any remaining portion of donations made in a year. Corporations claim a deduction from net income. Since the donation credit also affects surtaxes and provincial taxes, it can generate total tax savings of about 50 cents per dollar donated.

There is no limit on the amount that may be claimed for gifts to federal or provincial governments, while claims for gifts to charities and municipalities are limited to 20 per cent or an individual's (or corporation's) net income in a year. Donors are able to carry unused claims forward for up to five years, which in most cases ensures that they are able to claim the full value of their donations.

However, the value of donated land may often be high relative to the donor's income. As a result, the 20 per-cent rule may restrict the value of the donation credit, even after the five-year carry-forward is taken into account.

To further encourage the conservation and protection of Canada's environmental heritage, this budget proposes to exempt qualified donations of land, including qualified donations of covenants, servitudes and casements, from the annual limit of 20 per cent of net income.

In order to qualify for the exemption, donations must meet the following conditions:

- the donated land must be certified by the Minister of the Environment to be ecologically sensitive land, the conservation and protection of which is, in the opinion of the Minister, important to the preservation of Canada's environmental heritage; and

- the body to which the land is donated must be either a Canadian municipality or a registered charity that is designated by the Minister of the Environment at the time the donation is made to be a body whose primary purpose is the conservation and protection of Canada's environmental heritage for the benefit of all Canadians.

As well, it is proposed that bodies that receive such gifts of land be required to ensure that the lands are not subsequently sold or their use changed without the permission of the Minister of the Environment. Where there is an unapproved disposition or change in use of such land, the organization will be subject to a penalty equal to 50 per cent of the value of the land at the time of the disposition or change-in-use.

The Minister of the Environment will consult with interested parties to develop the criteria to be applied for the certification of ecologically sensitive land and the designation of qualified recipients.

This proposal will apply to gifts of land, covenants, servitudes and easements made after budget day.

The estimated revenue cost of this measure is small.

## Appendix 3

### Donors' Tax Balance

Consider the following, when the offset tax credit is used completely.

Where:

$v$ = fair market value

$v_i$ = initial cost, adjusted cost base

$P$ = tax payment

$r_m$ = marginal tax rate

On capital gain $\quad P_{cg} = .75\,(v - v_i)\,r_m$

Tax credit $\quad P_{tc} = -(v\,r_m)$

Net Payment $\quad Pnet = P_{cg} + P_{tc}$

$$= r_m\,(.25\,v + .75\,v_i)$$

Net Payment is positive (donor pays government) when $v > 3\,v_i$ .

## Appendix 4

## Notes from KPMG Peat Marwick Thorne, Chartered Accountnts

**High Tax Cost: An Example**

- The following adapts the previous example to show how the double tax benefit would generate a high tax cost to governments:

Sale of Property

| | | |
|---|---|---|
| 1. | Net proceeds | $64,900 |

Donation of Property

| | | |
|---|---|---|
| 2. | Declared value of the gift | $100,000 |
| 3. | Capital gains tax | $0 |
| 4. | Value of donation tax credit | $52,000 |

Net Cost of the Donation

| | |
|---|---|
| Dollars (1-4) | $12,900 |
| Relative to the value of the donated property | 13% |

*Key Points:*

- This example shows that if the capital gain were eliminated, the net cost of the donation to the donor would be only $13,000, or 13 per cent of the value of the land. Through the double tax break, the federal and provincial governments would provide a tax subsidy equal to 87 per cent of the cost of purchasing the land outright:

  - the donation credit would be worth about 52 per cent; and

  - the capital gains exemption would be worth an additional 35 per cent.

- This would create an incentive to inflate the estimate of the fair market value of donated land: for each additional dollar of appraised value, the donor would gain 52 cents through reduced taxes. If the appraised value were inflated, *the total tax cost of the donation could easily exceed the cost of purchasing the land outright.*

## Appendix 5

### Department of Finance Canada Calculations

| | | | Tax Cost (Benefit) |
|---|---|---|---|
| | Scenario 1<br>Sale/No Donation | Scenario 2<br>Donation/Taxable Gain | Scenario 3<br>Donation/Exempt Gain |
| Tax Payable on Gain ($6/.500 x 52%) | $35,100 | $35,100 | $ 0 |
| Donation Credit ($100,000 x 52%) | 0 | (52,000) | (52,000) |
| Tax Cost (Benefit) | $(35,100) (A) | $(16,900) (D) | $(52,000) (C) |
| Difference (A) - (C) | | | $87,100 |
| Difference (B) - (C) | | | $35,100 |

- Scenario 1: the "donor" sells the land for cash and does not make a donation.
- Scenario 2: the donor donates the land and the capital gain arising on the disposition is taxable.
- Scenario 3: the donor donates the land but the capital gain is tax exempt.

From the donor's perspective, the tax cost as calculated above is tax payable. The tax benefit is the donation credit (net of tax payable on the capital gain on the donated land (if any) which will reduce tax payable on the donor's income from other sources. The donor's tax cost is the government's tax revenue and, correspondingly, the donor's tax benefit equals the tax subsidy provided by the government.