

Considerations and Guidelines

For Establishing a Private Foundation

Like many Canadians, creating a legacy aligned to your personal values, beliefs and convictions is an important wealth planning priority. Establishing a private foundation can help you achieve and give meaning and structure to your philanthropic goals. This article will provide important considerations for establishing a private foundation.

What is a private foundation?

A private foundation is a philanthropic vehicle that provides the flexibility of developing various types of grants by you and your family. It is established and operated exclusively for charitable-giving purposes and can be structured as a trust or a corporation. Most foundations fulfill their charitable purpose through the disbursement of assets to registered charities or other qualified donees (explained below). Private foundations can also carry out their own charitable programs.

Trust versus corporation

A private foundation can be set up by way of a trust or a corporation. If a private foundation is set up as a trust, it will be managed by trustees. If it is set up as a corporation, the foundation will be managed by directors. The choice will generally be determined by your personal preference and should include a discussion with your independent legal advisor to ensure that the most appropriate structure is chosen to reflect your unique situation.

Depending on whether the foundation is set up as a trust or a corporation, there are different annual reporting and filing requirements, which are discussed below.

Is a private foundation right for you?

When considering setting up a private foundation, and with charitable giving generally, it is important to identify your philanthropic objectives:

1. Your motivations for giving;
2. The level of control you wish to have in your charitable giving;
3. The level of involvement from your family;
4. The level of autonomy you want linked to your granting activities¹; and
5. The overall legacy you are trying to create.

A private foundation can be a way to fulfill both tax-planning objectives and long-term philanthropic goals. It is also a great way to involve children and grandchildren in philanthropic activities and show them the value of giving back. However, there are costs involved in establishing and maintaining a private foundation, such as the initial professional fees associated with establishing the foundation and registering it with the Canada Revenue Agency ("CRA"). Philanthropic activities also become public record as private foundations are required to file an annual T3010 Information Return with the CRA, along with its most recent financial statements, both of which are available to the public. In addition, there are annual costs including fees for the ongoing investment and management of assets, general administrative and operating costs, and professional service fees for accounting and legal support when required.

Establishing a private foundation

A private foundation is created in two steps:

1. Deciding whether the foundation will be established as a trust or a corporation; and
2. Applying for charitable status with the CRA.

Private foundations must use their resources for charitable activities and have charitable purposes that fall into one or more of the following categories:

- Relief of poverty;
- Advancement of education;
- Advancement of religion; and/or
- Other purposes that benefit the community.

These two steps require the involvement of a legal professional, preferably one that practices in Canadian not-for-profit/charitable tax law. This process is independent to the services provided by your BMO financial professional and will generally take six months or more to complete. Depending on the complexities of the foundation's charitable purposes, establishment costs can range between \$7,500 – \$15,000. Obtaining independent legal advice is recommended to ensure that you are complying with the rules and regulations that govern private foundations.

Funding a private foundation

Unlike public foundations, private foundations are generally funded and/or managed by one individual or family. Funding for a private foundation can come from personal, family, or business assets. It is important to note that only after a foundation has received its charitable status from the CRA should it be funded. For a contribution to qualify as a gift for tax-receipt purposes, it must be a transfer of property by the donor for which no consideration is expected.

Foundations can accept donations of cash, publicly-traded securities, the proceeds of a life insurance death benefit, registered plans, and in some cases ecological property and Canadian cultural property. To have the assets of your private foundation managed by your BMO financial professional a commitment to fund \$1MM is recommended. The foundation doesn't have to be funded all at once, you can make your donation of \$1MM over several years.

If you have a taxable event, like the sale of a business, that may require an immediate need for a charitable tax credit, you may want to consider opening a Donor Advised Fund ("DAF") via the BMO Charitable Giving Program as an interim step. Establishing and donating to your DAF can generally happen within five business days, essentially ensuring the opportunity to secure a donation tax receipt by the end of the calendar year for income tax purposes. Unused donation tax credits can be carried forward but cannot be carried back (except in the year of death). Funds donated to your DAF can be later transferred to your private foundation once registration has been approved by the CRA. For more information on the tax treatment of gifts made to a private foundation, refer to a professional tax advisor.

What are the benefits of a private foundation?

Establishing a private foundation provides flexibility for donors who aim to achieve their philanthropic objectives through a strategic and long-term process.

1. Tax benefits

Donation Receipts: As a registered charity, a private foundation can issue donation receipts for gifts received from individuals and related corporations. The donation receipt is issued at the time the gift is made, but distributions to other qualified donees from the private foundation can be made in the future.²

Charitable Tax Credits: Both Federal and provincial or territorial charitable tax credit rates are available. A donor may claim tax credits for total gifts of up to 75% of their net income in a given year, subject to exceptions for gifts of certified cultural property or ecologically sensitive land (a donor may be able to claim up to 100%). The tax credit can be carried forward for up to five years.

The limit for using the charitable donation tax credit is increased from 75% to 100% of net income in the year of death. Any unused charitable donations in the year of death can be carried back one year.

Maximizing Gifts: Private foundations are exempt from paying income tax. This allows the foundation to make larger gifts to qualified donees. If the foundation meets its minimum annual disbursement quota (discussed below), it can accumulate income and grow its capital on a tax-free basis. There are additional tax benefits for gifts of certain types of property, including publicly-traded shares, mutual fund shares, segregated fund units, life insurance, registered plans, ecological property, and Canadian cultural property.

Obtaining independent tax advice is recommended to ensure that you are maximizing opportunities as well as complying with the rules and regulations that govern private foundations.

2. Sole control over the foundation

The principal donor of a private foundation can retain control over the foundation for decisions including, investment of assets, supported qualified donees, grant amounts, and timing of distributions. Having single control allows the foundation to be flexible and adapt to changes in the future.

3. Family involvement and creating legacy

Private foundations provide families with the opportunity to get involved in giving back and transfer the succession of philanthropic values to future generations. Children and grandchildren can participate in several different ways, including acting as trustees or directors and setting the charitable objectives of the foundation. A private foundation can be named in honour of the founding donor or in the name of the donor's family, thereby enabling the family to build a legacy in perpetuity.

Operating a private foundation

The governance framework for a private foundation will be outlined in the governing documents of the foundation. This would be the "articles of incorporation" or letters patent and the by-laws for a corporation. For a trust it would be the trust deed. The framework is created by the lawyer hired to establish the private foundation, in partnership with the founding donor.

Once the foundation is registered, the role of the trustees or directors is to ensure that it is working to achieve its charitable purpose(s), in compliance with legal and regulatory requirements. Trustees or directors should:

- Keep adequate books and records for each fiscal year of operations at an address in Canada that is on file with the CRA;
- Adopt an investment policy with specific objectives that are aligned with the foundation's charitable objectives;

- Establish proper internal policies and practices and/or adopt written policies and sets of practices to guide its trustees or directors and staff;
- Act honestly as fiduciaries, in good faith, and in the best interests of the foundation;
- Meet the annual disbursement quota for the foundation; and
- File a T3010 information return with the CRA, along with its most recent financial statement.

Once the private foundation is established as a corporation, there are additional compliance requirements. A corporation must file annual returns and must hold annual meetings, or in lieu thereof, pass annual resolutions. To ensure that your foundation is compliant, guidance and advice from your legal advisor is recommended.

Annual disbursement quota

Private foundations have an annual disbursement quota that requires the foundation to spend a specified percentage of the value of its assets, not used directly in charitable activities or administration, per year. The disbursement quota for a private foundation is 3.5% on assets up to \$1MM and 5% on assets over \$1MM, not used directly in charitable activities or administration. Your accounting professional will be able to help you determine the exact amount your foundation is required to disburse annually.

Under certain circumstances, if a foundation cannot meet the annual disbursement quota by using previously accumulated excesses or by encroaching on capital because it has insufficient funds, then it can apply for administrative relief to the CRA.

The annual disbursement quota is to ensure that private foundations use their investment assets to actively pursue their intended charitable purpose(s). It can be met by spending funds directly on the foundation's own granting activities or directing funds to other qualified donees.

Granting to qualified donees

A private foundation can carry on its own charitable activities, as approved by the CRA when applying to become a charity, and/or fund other qualified donees.

Qualified donees are organizations that can issue official donation receipts for gifts they receive from individuals and corporations, and include the following:

- Registered charity (including a registered national arts service organization);
- Registered Canadian amateur athletic association;
- Registered journalism organization;
- Registered housing corporation resident in Canada constituted exclusively to provide low-cost housing for the aged;

- Registered Canadian municipality;
- Registered municipal or public body performing a function of government in Canada;
- Registered university outside Canada, the student body of which ordinarily includes students from Canada;
- Registered charitable organization outside Canada to which His Majesty in right of Canada has made a gift;
- His Majesty in right of Canada, a province, or a territory; and
- The United Nations and its agencies.

His Majesty in right of Canada, a province, or a territory, and the United Nations and its agencies are qualified donees that do not have to be registered to be recognized as such.

How can your BMO financial professional help?

1. They can provide the names of three legal professionals for the purpose of creating a private foundation and obtaining independent legal advice. It is the responsibility of the legal professional that you select to provide you with legal advice, guidance and facilitate the creation of your foundation with the CRA. This relationship is separate and independent from the wealth professionals at BMO Private Wealth.
2. Once your private foundation is approved by the CRA and receives a registration number, your BMO financial professional can work with you and your accountant to determine which assets should be donated to your private foundation.
3. They can connect you to a member of the BMO Private Wealth Philanthropic Advisory Services team to help you:
 - Learn more about philanthropy in Canada;
 - Identify the values you want your foundation to perpetuate;
 - Translate your values into a mission statement for the foundation;
 - Develop granting guidelines to support the program goals of the foundation;
 - Research funding needs and opportunities;
 - Effectively assess funding requests made to your foundation;
 - Enhance your foundation's granting activities;
 - Monitor and evaluate the projects your foundation is funding with qualified donees; and
 - Ensure basic governance requirements are met using a risk mitigation strategy.

Seek advice

It is important to note that any legal, tax and compliance recommendations relating to your private foundation must be provided by your independent tax and legal advisor.

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



¹This relates to the activities with charities to determine whether to support a charity and how much, and assessing the impact of your grant.

²<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/qualified-donees.html>

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