

## Fair Market Value

### What is fair market value (FMV)?

In Canadian tax law, FMV is defined as:

'The highest price, expressed in dollars, that a property would bring in an open and unrestricted market between a willing buyer and willing seller, both of whom are knowledgeable, informed and prudent, and who are acting independently of each other'.

In non-legalese, this means that it's what you'd pay for something if you were buying it as a regular consumer.

What's more, if there's no way to find out the FMV of a property, a charity isn't allowed to issue a tax receipt. Nor is it OK to guess or estimate the value. It's that simple. Canada Revenue Agency takes infractions in this area very seriously.

### How is the fair market value of a gift determined?

It's easy to determine the FMV of **cash** gifts. It's the amount shown on the cheque, money order, or credit/debit card transaction record. If a donor sends your charity a cheque for \$100 in response to a direct mail campaign, the FMV of the gift is \$100.

For gifts involving property other than cash, which are known as '**gifts-in-kind**' or '**non-cash gifts**', determining FMV is more complicated. There are three main rules to remember:

1. If it is hard to find an independent appraiser or this would involve unreasonable expense and the FMV of the property is \$1,000 or less, a *qualified* employee of your charity can appraise the gift.
2. In all other situations, select a professional appraiser who is independent of both the donor and your charity and who is active in the marketplace for that specific type of property.
3. Gifts of certain property trigger a deemed FMV. The next page explains this in more detail.

## **Deemed fair market value (FMV)**

In 2003, CRA announced new rules to deal with 'buy low, donate high' schemes (or scams). Certain promoters were marketing charitable gifting schemes to individuals looking for a tax break. The schemes involved buying property at a fairly low price and donating (or flipping) it at a much higher value to a charity soon after.

In most cases, the donors actually made money using these schemes. They mostly involved art donations and were flagrant examples of people abusing the intent of the Income Tax Act's charitable donation framework.

The deemed FMV rules apply where a donor makes a gift of property acquired within the previous three years or through a 'gifting arrangement'. In these situations, the FMV of the property is deemed to be the lesser of the actual FMV and the donor's cost to acquire the property.

The good news is that many types of property that could concern your charity are exempt from these rules. For example, they do not apply to:

- Gifts made through a will
- Publicly traded securities
- Gifts from a business's inventory
- Real property located in Canada
- Certified cultural property
- Ecological gifts

All of these types of gifts are defined in your course glossary.

The deemed FMV rules do apply, however, to gifts of tangible property. Consider yourself warned. If someone approaches your organization about a gift of art, collectibles, antiques, jewelry, or other similar property, you must take into account the deemed FMV rules before finalizing a value to include in the tax receipt.

Here's what you need to do. Ask whether the donor purchased the property within the previous three years.

- If the answer is 'no' then you don't need to do anything further. Use a current appraisal to determine the FMV of the gift.
- If the answer is 'yes', then you must also ask the donor how much he or she paid for the property. You must use the lower of the two amounts – the purchase price and the current FMV – for the donor's tax receipt.

## Using the correct date for fair market value

As you know, the value of property can go up and down over time. Consider the stock markets. Share prices can jump up and down in a matter of seconds. The opening price of a company's stock this morning will more than likely be different than its closing price this evening.

This brings us to another important question when determining a property's FMV. At what exact point in time does a charity calculate FMV when preparing a donor's tax receipt?

The easy answer is that FMV is determined at the time the gift is 'complete'. In other words, FMV is calculated at the moment the donor's property has been received and accepted by the charity. Although this sounds straightforward, it's more complicated when you try to apply it to a specific situation because the law uses different rules depending on the type of property and the particular situation.

This can be a complex area of the law. If you are at all uncertain about the date or time to use when calculating FMV, get legal advice. In the sections below, however, we'll give you some general guidelines for determining FMV involving several types of property.

## Fair market value and tangible property

Tangible property is anything you can touch and see – art, books, jewelry, antiques, etc. Here are some points to remember when valuing and receipting these gifts:

1. The gift is usually complete when the donor has physically delivered the property to your charity (assuming, of course, that your charity intends to accept the property). That's generally the date you should use for valuation.
2. It's a good idea to have the donor sign a written document that confirms the date of the gift and gives a brief description of the property. This provides a paper trail that both your auditors and CRA can use to verify your donation receipts. The document is often called a 'deed of gift'. Don't let the name scare you. It can be quite simple and is usually no more than one page for a simple gift of tangible property.
3. Be sure to tell the appraiser that you want a sale value and not an insurance (replacement) value. The two amounts can be vastly different. For example, the amount a person would get when selling jewelry (sale value) is much less than it would cost to replace the same jewelry under an insurance claim (insurance/replacement) value.

## Fair market value and public securities

Public securities consist of any security (share, bond, stock option, unit, etc.) traded freely on a stock market or other mechanism operated by mutual fund companies or members of the Investment Dealers Association. Most gifts in this category consist of shares and, to a lesser extent, mutual fund units.

As a general rule, CRA considers the gift complete when the security has been re-registered in the charity's name, although that guideline doesn't apply for physical share certificates. In any event, re-registration happens differently depending on the type of security. Consider these three different examples:

1. Shares held electronically within the Canadian Depository System
2. Mutual funds
3. Physical share certificates

We'll then go on to look at why the transfer value of a security is often different than the sale value.

### 1. Shares held electronically within the Canadian Depository System

Today most owners of public company shares hold their shares within an electronic book-based system. In Canada, this system is called the Canadian Depository System (CDS). In general, a gift of shares held through CDS is complete when those shares are recorded in CDS on the charity's account.

CRA has published guidelines for determining FMV in this situation. You have two options:

1. Use the midpoint between the highest and lowest market price on the day that the shares arrive in your charity's account, or
2. Use the market price at the close of business on the day that the shares arrive in your charity's account.

As soon as the shares have been registered in your charity's account, your investment advisor should provide you with written confirmation of:

- The type of shares gifted (e.g. RBC common)
- The number of shares transferred to your account
- The FMV of the shares

All of this information will be used to prepare the donor's tax receipt.

## 2. Mutual Funds

Mutual funds are not registered through a centralized system like CDS. Each mutual fund company has its own system. This means it can take longer – up to ten business days – to transfer fund units from a donor to your charity. Your investment advisor should be able to work with you and your donor to complete the mutual fund company forms needed to make the transfer.

The valuation date for the gift is the date the units are re-registered in your charity's account at the mutual fund company. Your investment advisor should give you written confirmation of the:

- type and number of units transferred and
- units' FMV at the time re-registration is complete.

## 3. Physical share certificates

You may run into some older donors who hold old share certificates in their safety deposit boxes. The fact that there is a physical share certificate does make a difference to the date on which FMV is determined.

To transfer shares where there is a certificate, the owner needs to sign a bank power of attorney. Your investment advisor will be able to help you and your donor complete this document.

As soon as the bank power of attorney is properly completed and signed, anyone in possession of both the share certificate and the bank power of attorney can have the shares transferred. Therefore, as soon as your donor turns both documents over to your charity, ownership transfers and this is the date you should use to calculate FMV of the shares. It's irrelevant that it may take your charity several days to have the shares re-registered in its account. The gift is complete as soon as the donor gives you the documents necessary to transfer the shares into your charity's name.

### **Transfer value is different from sale value**

Most charities have a policy of selling public shares immediately after the gift is complete. Even so, the proceeds a charity gets on the sale will most likely be different from the FMV at the time the gift is complete for two reasons:

1. The share price will usually move up or down during the time it takes to complete a sale; and
2. Your investment advisor may take a commission on the sale.

The main point is this. Don't confuse the FMV of the shares for purposes of issuing the donor's tax receipt with the final amount your charity receives when selling the shares. In all likelihood the amounts will be somewhat different. The sale proceeds the charity receives have no bearing on the FMV amount used to prepare the tax receipt.

## **Fair market value and real estate**

A gift of real estate always requires at least one independent appraisal. If either the donor or your charity questions that appraisal, you may need a 'second opinion' from a different appraiser.

You will need to exercise some judgment in determining FMV, and you have to be able to defend the way in which you arrived at the valuation. For example, in a rapidly rising or falling market, it may be important to have your appraisal done within a few weeks or even days of transferring the property. If the market is less volatile, it might be possible to rely on a slightly older appraisal. It depends on the situation but you're wise to err on the side of caution for the sake of both your charity and the donor.

You will always need to engage a lawyer to complete a gift of real estate. He or she will be able to tell you the date on which the gift is complete. Typically, the completion date will be the date on which title to the property is re-registered at a land title or land registry office. However, the law and practice varies from province to province and situation to situation, so you must rely on your own lawyer for correct information.

## **Fair market value and shares in private companies**

Gifts of shares in a private company are relatively uncommon. However, as many of Canada's wealthiest donors are entrepreneurs running one or more businesses, it's important to prepare for this kind of gift.

Be aware, however, that CRA will spend extra time reviewing a gift involving a private company. It's very important to get expert advice from both lawyers and accountants who are knowledgeable in business, tax and charitable law.

Since valuation of these shares is a complex process, you must also engage a professional business evaluator. There are many factors that can affect the value of private company shares so you should obtain professional advice on managing this type of gift.

The professional fees charged for structuring these gifts are substantial so ensure that the amount your charity expects to realize from the gift warrants the cost of getting this professional help.

## **Fair market value and gifts of certified cultural property**

Unless your charity is an art gallery or a museum, or it is a public institution that operates an art gallery or a museum, you will not likely need to deal with gifts of certified cultural property.

According to CRA policy, certified cultural property is:

*A property of outstanding significance and national importance to Canada, for which a certificate has been issued by the Canadian Cultural Property Export Review Board.*

In other words, it's the work of famous Canadian artists or artifacts of national historical or cultural significance. Think galleries and museums.

A detailed process for accepting and receipting certified cultural property has been established by the federal Department of Canadian Heritage. Valuation of cultural property for tax receipting purposes obviously forms an important part of that process. FMV of cultural property is determined by the Canadian Cultural Property Export Review Board, although a donor who disagrees with that FMV can appeal to the Tax Court of Canada.

For more information on gifts of certified cultural property click on 'Canadian Cultural Property Export Review Board' in the index at <http://www.canadianheritage.gc.ca>.

## **Fair market value and gifts of ecologically sensitive land**

The ecological gifts program is administered by Environment Canada. Ecologically sensitive lands are '*areas or sites that currently or could, at some point in the future, contribute significantly to the conservation of Canada's biodiversity and environmental heritage.*' Only certain charities, such as land trusts, are eligible to receive ecological gifts.

The FMV of an ecological gift must be certified by the federal Minister of the Environment. The donor must submit an independent appraisal of the property's FMV to a regional Ecological Gifts Program Coordinator, along with a signed *Application for Appraisal Review and Determination*.

For more information on the Ecological Gifts Program at Environment Canada see <http://www.cws-scf.ec.gc.ca/egp-pde>