Making a Difference with Charitable Giving Strategies

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Many of our clients have told us during the development of their financial plan, *"I want to make a difference"*. This simple statement often sums up the desire of many individuals to help those less fortunate. The simple response is that there are many worthy charities that would appreciate a donation. The better response is, if we take the time to consider the donor's tax and estate planning objectives, the charitable gift can help to meet their own long term objectives and may allow them to give more to their chosen charities. In other words, planned philanthropy can benefit the donor, their family and the charity.

The purpose of this publication is to briefly explain how charitable donations are treated for tax purposes in Canada and provide a summary of opportunities that may be used to implement planned philanthropy. It is not intended to provide tax or legal advice and therefore should be reviewed with the appropriate investment, accounting and legal advisors.

Charitable Giving and Your Tax Bill

In addition to supporting a chosen charity in its efforts, individual taxpayers may claim the donated amount on their tax return and receive a non-refundable federal and provincial tax credit that is applied against their taxes owing. The taxpayer can claim donations that have a total value of up to 75% of their net income in any one year (in the year of death, the maximum rises to 100% of the deceased's income). If the donation exceeds the maximum allowed in any one year, the taxpayer can carry forward the excess amount and claim it over any of the next five years.

The federal credit is calculated by multiplying the lowest federal tax rate of 15% times the first $200 of donations and 29% times all amounts over $200 (10% and 21% in Alberta). This tax credit is claimed on the tax return reducing the federal and provincial tax payable. This means that for someone in the top tax bracket, they are saving close to 50 cents of every dollar donated to a registered charity. For purposes of this publication we have simplified our illustrations by ignoring the calculation on the first $200 and assumed a generic 50% tax rate. The actual tax savings will vary depending on province of residence and applicable tax bracket. See the next section for an illustration of a donor in the top tax bracket.

Tax Tip: Spouses should consider pooling their donations and have the higher income earning spouse claim the total to maximize their tax savings.

Give Securities or Other Property instead of Cash

Simply writing a cheque or charging a credit card is the most common means of donating but there may be better alternatives. This is where planned philanthropy can start to play a role. Often donors may have publicly traded securities such as stocks, bonds or units of a mutual fund that have appreciated significantly since its purchase. Thus they face a significant capital gain and tax liability when the asset is sold. The donor can share their good fortune with their chosen charities and significantly reduce their tax bill by making an "in-kind" donation of the asset. An "in-kind" donation is where the donor transfers the ownership of an asset such as a security or depreciable property (eg. a building) to the charity receiving a donation receipt for the fair market value of the asset on the date of transfer. Since ownership has transferred, the donor is deemed to have disposed of the asset triggering a taxable capital gain. Normally, 50% of a realized capital gain is taxable in the year of sale but if the "sale" is by way of an in-kind donation 0% of the capital gain is considered taxable.

An "In-kind" donation is a real windfall for the donor and the charity since it is an effective tax planning strategy for the donor and can lead to a much larger donation. The alternative is for the donor to sell the asset and donate the after-tax cash. In addition, "in-kind" gifts allow the donor's maximum donation credit to increase to 100% of their net income in the year. See the table below to understand this benefit.

"In-kind" Donation Illustration	Sell Security and Donate Cash (net of tax)	Donate Security
(A) Fair Market Value of Security	$100,000	$100,000
(B) Adjusted Cost Base of Security	$40,000	$40,000
(C) Capital Gain (A – B)	$60,000	$60,000
(D) Taxable Capital Gain	(C) x 50% = $30,000	(C) x 0% = $0
(E) Tax Payable (D) x 50% tax rate	$15,000	$0
(F) Amount Donated	(A) – (E) = $85,000	$100,000
(G) Donation tax credit (@ 50%)	$42,500	$50,000
(H) Net tax savings (E) – (G)	$27,500	$50,000
Net Benefit of "In-kind" Donation	-	**$22,500**

Give Registered Retirement Income Fund (RRIF) Payments

Many investors will accumulate significant retirement savings in their RRSP with the intention of withdrawing it in retirement by converting their RRSP to a RRIF. Once in retirement, many will defer withdrawals from their RRSP until they need the additional income. Unfortunately, by the end of the year the RRSP holder (ie. annuitant) turns age 71 they must convert their RRSP to a RRIF or annuity and begin to receive at least an annual minimum payment. This minimum payment ranges from 7.38% of the RRIF value at age 71 to 20% of the value by age 94. Thus, these payments can become large and are treated as additional taxable income subject to the individual's marginal tax rate. By donating all or a portion of these payments to a charity, the donation tax credit will serve to offset at least part of the additional tax payable. See the adjacent table.

Tax Savings by Donating RRIF Payments to Charity	
(A) Taxable Income	$150,000
(B) Minimum RRIF payment	$15,000
(C) Add'l tax payable due to RRIF payment (assuming 50% tax rate)	(B) x 50% = **$7,500**
(D) If RRIF payment donated	$15,000
(E) Tax savings from donation tax credit (assuming 50% rate)	(D) x 50% = $7,500
(F) Add'l tax payable due to RRIF Payment	**$0**

Give Employee Stock Options

Many executives of publicly traded companies are paid a significant portion of their total compensation in the form of employee stock options. Over time, these executives accumulate significant wealth in options and "exercised" shares of their employer. From an investment perspective, this is a concern because too often the executive's total wealth is concentrated in one stock and therefore it will rise and fall with the stock price. In some cases, this can be disastrous if the employer goes bankrupt (eg. Nortel). If the executive wishes to reduce their wealth concentration and give to their chosen charity, this can be done in a tax efficient manner with stock options.

Normally, when stock options are exercised, the difference between the stock's fair market value on the exercise date and its exercise price is considered a taxable employment benefit and is effectively taxed at the same rate as a capital gain. This means that 50% of the difference is taxable as income. However, if the stock is donated to a registered charity within 30 days of the exercise date (provided it is within the same calendar year) the tax is eliminated.

Give through a Corporation

For individuals with a corporation there can be considerable tax benefits to gifts made through it. The first benefit is that a corporation can claim the donation as a deduction rather than a tax credit. The value of the tax deduction depends on the company's effective tax rate. "In-kind" donations of securities receive the same tax treatment as an individual (discussed previously). In addition, the total value of the non-taxable capital gain triggered on the donation of the securities is credited to the capital dividend account (CDA) of the corporation. This CDA credit can allow for at least some funds remaining in the corporation to be withdrawn by the donor tax free. Planned philanthropy can be a powerful planning tool for corporate donors.

Give a Life Insurance Policy

Life insurance policies are often purchased to protect one's family in the unfortunate event of an untimely death. Over time, as a person acquires additional wealth, the need for this policy may lessen as their estate may provide the necessary protection. The policyholder could consider donating the policy as part of their estate plan.

To give a life insurance policy, the donor transfers ownership of the policy to a charity, as well as making the charity the beneficiary. If the policy is permanent insurance such as whole or universal life, the current cash surrender value of the policy is considered the initial donation. Once the policy has been donated, any additional premiums paid by the donor are also considered a donation, earning additional tax savings. This strategy can be used with both new and existing life insurance and should be considered within the context of the donor's overall estate plan. Other more complex insurance products may also be used within a planned philanthropy strategy.

Give using a Charitable Remainder Trust

A donor that owns an income-generating property such as real estate can establish a charitable remainder trust. This is an inter-vivos or living trust that gives the property to the charity, but ensures that the donor continue to receive the property's income for the rest of their life. The gift to the trust is recognized at fair market value on the date of transfer and any capital gain is treated in the same manner as was discussed previously with "in-kind" donations. The end result is the donor receives a tax credit for the value of the property transferred to the trust; continues to receive income from the trust; while the charity become the beneficiary of the property. This is a more complicated means of making a charitable gift because of the set-up and on-going cost of the trust but it can be an effective tax and estate planning strategy.

Develop a Philanthropy Plan

This summary provides a brief explanation of the most common charitable giving strategies available. There are many factors that should be considered when developing a philanthropy plan beginning with which charities will benefit from your good fortune. It is important to take the time to plan the most effective means of making donations both during your lifetime and as part of your estate. This is best achieved within the context of a broader financial plan and with the assistance of your investment, tax and legal advisors.

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