CI ASSANTE
PRIVATE CLIENT

REFERENCE GUIDE

WEALTH PLANNING GROUP

CHARITABLE GIVING

CI Assante Private Client, a division of CI Private Counsel LP

In order to promote and encourage charitable giving, the *Income Tax Act* of Canada (the Act) allows a tax credit to be claimed for eligible charitable gifts made by an individual either during a taxation year (and in the five preceding years if not previously claimed), by will or beneficiary designation, or by the individual's estate after the individual's death. This federal tax credit is added to the other non-refundable personal credits, and the total is then deducted from the taxes otherwise payable by the individual or estate, resulting in a lower income tax liability.

The Act also allows a tax deduction to be claimed for eligible charitable gifts made by a corporation, which can be used to deduct taxes otherwise payable by the corporation, resulting in a lower income tax liability for the corporation.

Generally, the tax credit available for charitable gifts does not fully offset the amount donated to charity, so there clearly must be a charitable motive underlying the gift. However, once a decision to give to charity is made, the gift may be structured to maximize the resulting tax benefits. This reference guide outlines some of the important tax rules regarding charitable giving, as well as some of the various giving options available.

Donations by individuals

HOW IS THE FEDERAL DONATION TAX CREDIT CALCULATED?

The amount of the federal charitable donation tax credit is calculated as follows:

- for the first $200 donated, the credit is calculated based on the lowest marginal tax rate
- for amounts over $200, the credit is calculated based on the highest marginal tax rate if the individual has income that is taxed at the highest marginal tax rate. Otherwise the credit is calculated at the second highest marginal tax rate.

Currently, this translates to a credit of 15% of the amount of the gifts up to $200, 29% of the amount of the gifts over $200 for donors with $214,368 or less of taxable income, and 33% of the amount of the gifts over $200 for donors with more than $214,368 of taxable income.

Note that each province and territory also provides its own tax credits for charitable donations, which will provide additional tax savings. This reference guide addresses only the federal charitable donation tax credit.

Transfer of credit to spouse

Charitable donation tax credits may be transferred between spouses (though, as of January 1, 2016, spousal sharing of donation tax credits is no longer be available with respect to donations made by will or beneficiary designation). It is therefore advantageous in many circumstances for spouses to combine their donations in the tax return of one spouse if the total amount donated is over $200, since it will result in more of the donations being eligible for the higher tax credit.

Eligible charities

In order to be eligible for a donation tax credit, a gift must be made to one of the following:

- a registered charity
- a registered Canadian amateur athletic association
- a registered national arts service organization
- a registered housing corporation resident in Canada set up only to provide low-cost housing for the aged
- a registered Canadian municipality
- a registered municipal or public body performing a function of government in Canada
- the United Nations or an agency of the United Nations
- registered universities outside Canada that are prescribed universities, the student body of which ordinarily includes students from Canada
- Her Majesty in right of Canada, or a province or territory
- a registered foreign charitable organization to which Her Majesty in right of Canada has made a gift, or
- a registered journalism organization (which was included on the list as of January 2020).

If obtaining a charitable tax credit is important, it is advisable to review with a professional whether the intended recipient organization or institution is an eligible charity for the purposes of the donation tax credit.

Donation tax credit limits

There are limits to the amount of the donation tax credit that may be utilized in any one year:

LIMITS TO DONATIONS MADE DURING LIFETIME

During their lifetime, a donor is limited to using, in any given year, a credit not greater than 75% of the donor's net income for tax purposes for the taxation year (referred to as net income in this reference guide).

If the gift is capital property, the 75% limit is increased by:

- 25% of the taxable capital gain arising from the gift in the year, and

- 25% of the lesser of:
  - any recapture of capital cost allowance on the property included in the taxpayer's income in the year, and
  - the property's capital cost or fair market value (whichever is less).

Essentially, this means that when a gift of capital property is made, the donation limit will be increased to take into account the capital gain and any recapture arising from the gift.

LIMITS TO DONATIONS MADE BY WILL

Rules for bequests made in 2016 or later years provide more flexibility for claiming charitable donation tax credits related to charitable gifts made on death. The rules apply to gifts made by will, beneficiary designation and an individual's estate. Gifts made in these three circumstances are now deemed to be made by the deceased individual's estate. As a result, it is no longer necessary to distinguish between gifts made by will and gifts made by an individual's estate for donation tax credit purposes, as it was under the previous rules that deemed a gift made by will to be made in the final year of the deceased's life. Gifts made in these three circumstances will be valued as of the date they are transferred to an eligible charity.

Under the new rules, executors have increased flexibility to allocate gifts made within 60 months of death by beneficiary designation or by a qualifying estate among any of the following years:

- the year the gift is made by the estate
- any year of the deceased's estate before the gift is made by the estate
- the final two years of the deceased
- any five years after the gift is made by the estate.

A qualifying estate is an estate that meets the following conditions:

- all of the contributions to the estate must be made as a consequence of an individual's death
- the individual's social insurance number is provided in the estate's tax return
- the estate is designated as the graduated rate estate of the individual in its first taxation year
- no other graduated rate estate designation is made in respect of the individual.

Special rules in the Act provide for an enhanced donation limit in the year of death and the immediately preceding year. The donation limit in the year of death and the immediately preceding year is 100% of the deceased net income. If the charitable gifts are claimed in the

estate's tax returns, the donation limit is 75% of the net income of the estate. As stated above, donation tax credits resulting from charitable gifts made in your will cannot be claimed by your spouse, unlike gifts made during your lifetime.

Charitable giving options (and their tax implications)

GIFTS OF CAPITAL PROPERTY

Ordinarily, for income tax purposes, any property gifted during life is deemed to have been disposed of by the person making the gift for proceeds equal to the fair market value of the property. Similarly, on death, an individual is considered to have disposed of all of his or her property for fair market value.

However, in the case of charitable gifts of capital property, some special rules apply. If the fair market value of the gifted property is greater than its cost, the person making the gift is permitted to designate an amount to use as both the proceeds of disposition (for calculating any capital gain on the disposition) as well as the fair market value of the gift (for calculating the charitable donation tax credit). The amount designated must be an amount between the cost and the actual fair market value of the property.

These rules give the individual the flexibility to designate an amount that is most advantageous, depending on the individual's own circumstances. In the right circumstances, realizing all or a portion of inherent capital gains for tax purposes can achieve a better tax result than not realizing such gains, as demonstrated in the example below:

EXAMPLE OF GIFT OF CAPITAL PROPERTY

Assumptions:

- During their lifetime, a Canadian resident donates a property with a fair market value of $100,000 to a charity.
- The individual paid $10,000 for the property.
- The individual earns annual income of $75,000.
- The taxable portion of capital gains is one-half of the gain.

Under the tax rules, the individual could designate an amount ranging from $10,000 to $100,000 as the proceeds of the disposition. The following illustrations demonstrate the different results of designating the lowest amount ($10,000) and the highest amount ($100,000):

Illustration #1 - Designating the lowest amount

If the individual designated $10,000 (that is, the cost amount) as the proceeds of disposition, there would be no capital gain and the individual could claim a donation of $10,000.

With an income level of $75,000, the maximum amount of charitable donations that would be eligible for the donation tax credit for the year is $56,250 (75% of net income of $75,000).

Accordingly, the individual could claim the entire donation of $10,000, and would receive a federal tax credit of $2,872 (15% of $200 + $29% of $9,800). This could be applied against the federal taxes payable on the $75,000 income, which would be about $10,725 (taking into account only the basic federal personal credit, and not any other tax credits that might be available or any provincial taxes or tax credits). As a result, federal taxes would be reduced to $7,853.

Illustration #2 - Designating the highest amount

If the individual designated $100,000 (that is, the current value) as the proceeds of disposition, there would be a capital gain of $90,000 ($100,000-$10,000 cost). The individual's net income for the year would therefore be $120,000 (comprised of income of $75,000 + $45,000 as the taxable portion of the capital gain).

As a result of the capital gain, the maximum amount of charitable donations that would be eligible for the donation tax credit for the year would be $101,250 (75% of net income of $120,000 + 25% of $45,000 (the taxable capital gain)).

Accordingly, the individual could claim the entire donation of $100,000, and would receive a federal tax credit of $28,972 (15% of $200 + 29% of $99,800). Without taking into account any other tax credits or any provincial taxes or tax credits, the federal taxes payable on taxable income of $120,000 would amount to about $21,210 (taking into account only the basic federal personal credit). As a result, the federal tax credit for the donation would completely eliminate federal taxes in the year of the donation, leaving a tax credit balance of about $7,762 still available to be applied against taxes owing in the next five years.

Note that the designation of the amount must be made in the tax return for the year that the gift is made. If the individual has died, then the designation would be made by the executor or personal representative of the individual's estate.

GIFTS OF SECURITIES

As noted above, making a gift of capital property can result in the realization of a capital gain if the designated value of the property is greater than its cost. Currently, one-half of this gain would be taxable in the year the gift was made.

While securities are considered capital property, special tax rules have been in place, starting in 1997 and enhanced over the years, that make the donation of certain securities very attractive. In particular, there is now no tax on capital gains on the donation of qualifying securities to an eligible charity, including a public or private foundation.

Special rules apply where a gift of securities is made by will, so that the deemed capital gains arising on the death of an individual will be eliminated. Donations of qualifying securities acquired under employee stock options also qualify.

The types of securities eligible for this treatment are:

- securities listed on a stock exchange (that is, shares, debt obligations and rights)
- a share or unit of a mutual fund
- an interest in a segregated fund
- certain government or government-guaranteed debt obligations.

These rules clearly result in a greater tax benefit if a gift to charity is made by giving securities that have increased in value directly to charity rather than selling the securities and donating the proceeds.

GIFTS INVOLVING LIFE INSURANCE OR RRSPS / RRIFS AND TFSAS

Gift of an insurance policy

Another way to donate to charity is to transfer the ownership of a permanent life insurance policy, such as a whole life or universal life policy, to a charity and to name the charity as the beneficiary. The donor may also choose to continue paying the premiums or may have the charity make the payments.

For tax purposes, there is an immediate tax credit for the amount of the cash surrender value of the donated policy plus any accumulated interest and dividends that are also assigned (less any outstanding policy loan). Furthermore, if the donor continues to pay the annual premiums on the policy or contributes the funds to the charity so that the charity can pay the premiums, the premium payments will be treated as additional charitable gifts. This would enable the donor to claim an annual donation tax credit for the amount of the premiums.

Ultimately, a relatively small contribution by the donor can turn into a sizable gift to charity on the donor's death. Note that there would be no further donation tax credit at that time on the payment of the life insurance proceeds to the charity.

Gift of insurance proceeds through will

As an alternative to the above strategy, a donor could name his or her estate as the beneficiary of a life insurance policy and then include a gift to charity by will equal to the amount of the life insurance proceeds. This method allows the donor to retain control of the policy so that the charity or beneficiary could be changed by simply amending the will. However, no tax credit is available for the premiums paid, as with the gift of policy noted above.

When the insurance proceeds are paid to the estate, and the directed bequest is paid to the charity in accordance with the donor's will, a donation receipt would be issued for the amount of the gift, which would create a large tax credit. Where the insurance proceeds are gifted through will, if the donor's estate is a qualifying estate, the executor has increased flexibility to allocate the donation tax credit, as described above.

Naming a charity as beneficiary of life insurance or registered plan proceeds

Naming a charity as the beneficiary of life insurance proceeds or registered plans is another charitable gifting option. The executor has increased flexibility to allocate the donation tax credit resulting from proceeds of RRSPs, RRIFs and TFSAs, or life insurance, and paid, directly to a charity in respect of gifts made by beneficiary designation, as described above.

This option also allows the proceeds to pass to the charity outside the estate, which eliminates probate fees on the proceeds in applicable jurisdictions. Similar to the gift by the will, the payment of premiums does not create a charitable tax credit, but the payment at the time of death of the insurance proceeds will qualify for the credit.

DONATING THROUGH CHARITABLE FOUNDATIONS

Private foundations

Wealthy individuals and their families who intend to make significant charitable contributions into the future may wish to establish a private foundation as a vehicle for their charitable giving. A private foundation is a corporation or trust registered with the CRA that is organized and operated exclusively for charitable purposes. Once established as a registered charity, donations made by the individual or family members to a private foundation, either during their lifetime or by will, qualify for the charitable donation tax credit.

The use of a private foundation gives the individuals and their family members the opportunity to be involved in deciding how and where the foundation's funds are disbursed.

As discussed above, the favourable tax rules relating to gifts of publicly traded securities to a registered charity also apply where the charity is a private foundation.

Because the establishment and ongoing administrative requirements of a private foundation are complex, it would be important to obtain professional advice if this option is being considered. Further information on this topic can be found in our reference guide on private and public foundations.

Public foundations

A public foundation is a registered charity that receives most of its funds from many contributors, rather than from a single individual or family group, as with a private foundation. Typically, a public foundation provides an opportunity for donors to leave perpetual legacies for the benefit of a particular community or district. Many cities in Canada, for example, have community foundations whose goals are to improve and enhance the quality of life of their residents.

Many public foundations enable donors to direct how the income from the donation is to be distributed. For example, the income could be directed to a particular charity or to be used for a preferred area of interest, or it could simply be left to the foundation's directors to decide. Generally, such directions are made at the time of the gift (or in the will). Some public

foundations also permit donors (or their representatives) to make recommendations each year regarding the distribution of the income, providing an opportunity for more involvement in charitable giving.

Further information on this topic can be found in our reference guide on private and public foundations.

Donor-advised funds

A donor-advised fund is a type of special account, available through certain public foundations, that enable individuals and their families to make planned donations. A common donor-advised fund held by Assante clients is established through the public foundation, BenefAction. Similar to a private foundation, BenefAction allows an individual to make a charitable gift and enjoy an immediate tax benefit of the charitable donation tax credit. Holders of donor-advised funds can advise on where to direct funds, but with much less control when compared to a private foundation. However, the administrative requirements and costs are far less burdensome than a private foundation, making donor-advised funds a popular alternative.

Donations to a donor-advised fund can often be used for strategic tax purposes. An individual may have a tax year that will be unusually high amount of income, such as at the time of a sale of a business or other capital asset. The donor may make a substantial donation to a donor advised fund in that same tax year to offset some of their tax liability. In the years that follow, the donor can advise how they would like the funds used, sometimes in the same manner as if they had made smaller annual donations. The intention is to match the year of tax liability with the charitable donation tax credit but maintain the flexibility of donations in the future in amounts and to charitable purposes determined by the donor at the time.

Further information on this topic can be found in our reference guide on private and public foundations.

OTHER CHARITABLE GIVING OPTIONS

In addition to the options for charitable giving that are discussed in this reference guide, there are also other ways to donate to charity. For example:

- Charitable remainder trusts offer a way to make a future gift to charity, while obtaining a current tax credit.
- Charitable giving can also be accomplished through the use of annuities in several different ways, enabling older donors to make donations while maintaining the security of income payments throughout their lifetime.
- There are special rules relating to donating works of art, certified cultural property, qualifying ecological property and shares acquired by exercising stock options.

GIFTING ARRANGEMENTS

When considering making charitable gifts, it is important to be aware of certain rules that address concerns regarding certain charitable gifting arrangements. Under these arrangements, individuals would typically purchase property at a discounted price and then donate the property and obtain a tax receipt for an amount greater than their actual cost of the donated property.

Under the rules, the fair market value of the donated property, for the purposes of the charitable donation tax credit, will be considered to be either the fair market value of the property or the donor's actual cost of the property, whichever is the lower amount. These rules apply in the following situations:

- If the property was purchased less than three years before it was donated or less than 10 years before it was donated if one of the main purposes of the purchase was to donate the property to an eligible charity (unless the donation was made as a result of the donor's death); or
- If the property was acquired as part of a gifting arrangement. This would include any arrangement where it may be reasonably considered that a person would enter into the arrangement in order to make a gift to an eligible charity (or to incur limited recourse debt that relates to such a gift).

Certain types of property are excluded from these rules, such as:

- inventory
- real property in Canada
- certified Canadian cultural property
- ecological gifts
- publicly traded securities.

Donations by corporations

When a corporation makes a charitable donation to a registered charity, it is entitled to a tax deduction in the amount of the donation up to a maximum of 75% of the corporation's net income for the year. The 75% limit may be increased by up to 25% of the amount of the donation where the property donated is capital property or depreciable capital property giving rise to recapture. There is a five-year carryforward available for any amounts over these limits that a corporation is unable to deduct in the year of the donation.

Alternatively, a corporation may be able to claim a business deduction for donations made to a registered charity where some type of public recognition is given to the corporation by the charity (i.e., the donation can be treated as, for example, an advertising expense).

Enhanced tax benefits are available when a corporation donates publicly listed securities or an ecological gift. When a corporation donates these types of property, the tax on any capital gain arising from the disposition of the property to the charity will be eliminated and the corporation will be able to add 100% of the capital gain arising from the disposition to its capital dividend account (the amounts which can be flowed out to the corporation's shareholders on a tax-free basis). These benefits are in addition to the tax deduction that the corporation can claim as a result of making the donation. Thus, the tax benefits for a corporation when donating these types of property are very attractive.

Conclusion

With the wide variety of charitable giving options available, and the detailed tax rules that apply, charitable-minded individuals and corporations should consult with knowledgeable professionals to plan and implement their charitable giving, to ensure that they make the most of their contributions for themselves and their favourite charities.

For more information, we encourage you to speak to your advisor or visit us at assante.com

This document is intended as a general source of information and should not be considered personal, investment, tax, accounting or legal advice or an offer or solicitation to buy or sell securities. Every effort has been made to ensure that the material contained herein is accurate at the time of publication however it is subject to change without notice. We cannot guarantee its accuracy or completeness and we accept no responsibility for any loss arising from any use of or reliance on the information contained herein. You should seek professional advice before acting on the basis of information herein. Wealth planning services are provided through CI Assante Private Client, a division of CI Private Counsel LP. This document may not be reproduced, in whole or in part, in any manner whatsoever, without prior written permission of CI Assante Private Client.

© 2021 CI Assante Private Client. All rights reserved.

Published December 14, 2020.