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Charitable giving strategies –tax efficiencies for your philanthropic goals

Charitable giving allows you to help those most at risk, but it doesn't end there. Charitable groups in Canada consist of educational institutions, amateur sports organizations, religious groups and even governments at various levels. However, not all donations create the same result from a tax and estate planning perspective. Review the various ways below to plan your charitable giving and maximize your estate and tax saving goals.

Allowable gifts

You can gift almost any asset so long as a charity is willing to accept it. Common gifts include cash, marketable securities, life insurance proceeds and registered retirement savings plans (RRSPs). In most cases, the value of the gift is its fair market value. Your chosen charity will give you a charitable tax receipt based on this value when they get the gift. You can then use the tax receipt to lower your overall taxes.

Charitable donation tax credit

To encourage charitable giving, the federal and provincial governments give tax incentives when you make charitable contributions. The value of the donation translates into the tax incentive. Federally, tax credits are:

Donation amount	First $200	Over $200
Federal tax credit	15%	29% to 33%

The higher 33% is available to higher income earners who pay at the top tax rate.

Provincial tax credit rates vary across the country between 4% and 25.75%. Together with the federal credit, the combined donation credit is 19% to 54.75% depending on the province.

During your lifetime you can claim donations up to 75% of your net income (100% in Quebec). You can claim donations not used in the current year in the following five taxation years. Spouses or common law partners can combine their donations to increase their tax benefit.

Estate donations

In the year of death, you can claim eligible donations up to 100% of net income. You can also carry back unused donations to the year preceding death. This can help those with significant taxable income on their final return and creates an estate planning opportunity. The value of the donation is the value at the time the property transfers to the charity. Your estate can also make donations and can carry forward any unused tax credit for five years from the date of gift. Where your estate is a graduated rate estate (GRE), there is more flexibility in applying the donation tax credit. A GRE is a specific election for the first 36 months of an estate that meets specific conditions. Your tax advisors can review this with you. When your estate qualifies as a GRE, it can allocate donations it makes against:

- the taxation year of the estate in which the property is donated,
- an earlier taxation year of the estate, or
- the taxation year of death and the year preceding death of the deceased person.

Flexibility on claiming donations provides greater planning choices for reducing taxes between your estate and your individual returns. GRE status is also important when you name a charity as direct beneficiary of life insurance or registered assets. We discuss this below.

Donating cash and appreciated securities

Cash donations are the simplest form of donation you can make. Cash donations generate a tax receipt for the amount you donate. To generate the cash, you may need to sell the underlying asset which can attract capital gains tax. If that asset is marketable securities, you may benefit from an additional tax planning opportunity. Marketable securities include publicly traded mutual funds, stocks, bonds, and other securities listed on a designated stock exchange. When you donate marketable securities 'in kind', you eliminate the capital gains tax payable on the accrued gain. 'In kind' means you donate the asset itself, rather than liquidating it and donating the cash. Let's look at an example:

	Sell security and donate cash	Donate security 'in kind'
Fair market value of security	$50,000	$50,000
Adjusted cost base of security	$22,000	$22,000
Capital gain on disposition	$28,000	Nil
Capital gains tax (assuming a 25% tax rate)	($7,000)	Nil

Selling the security and donating cash creates tax. You would use the charitable donation tax credit to offset the tax. You can then claim any remaining amount against other taxes you owed. However, the in-kind donation will not create tax because of the 0% capital gains inclusion rate. You can then use the entire charitable donation tax credit to reduce other taxes owing. Looking at it another way, the tax becomes a cost to the donation. The tax savings when donating appreciated securities becomes an important feature.

Registered accounts

Many Canadians use registered accounts like RRSPs to save for their retirement tax efficiently. At age 71, your RRSPs convert to a registered retirement income fund (RRIF) with forced annual distributions. You may not need all the savings during your lifetime. However, the RRIF withdrawals are taxable income to you annually. Or, you may still have a balance in your RRIF at death. At this point, the entire balance is taxable income on your final return. You may reduce the taxes associated with these accounts during your lifetime by gifting RRIF withdrawals to your chosen charity.

You can also reduce taxes at death by naming a charity beneficiary of the RRSP/RRIF (outside of Quebec). Direct beneficiary designations are not available in Quebec unless made through an insurance contract. For those in Quebec you may still name a charity as beneficiary in your will. At death, the charity gives a receipt for the full value it receives. Your estate then offsets the taxes created by the RRSP/RRIF. In provinces with high probate costs, this strategy also helps to lower your probate costs. Note that your estate must be a GRE to use the credit against your final return or the year prior to death.

Life insurance

You can also maximize your donation to a charity and help lower taxes using life insurance. You can do this either during your lifetime or for your estate at death. There are two ways to use life insurance to leave a legacy.

1. **You can make a charity the beneficiary of your life insurance policy.** On passing, the charity gives your estate a tax receipt for the death benefit it receives. Your estate can use the receipt to lower its tax bill. Alternatively, if your estate is a GRE, your executor can choose to use the donation amount in the year of death. Or your executor can choose to carry back donations to the year preceding death to reduce taxes.

2. **You can change ownership of a newly issued or existing policy to a charity.** The premiums you pay annually generate an annual donation receipt from the charity. On death, the charity receives the death benefit. Because the charity is the owner, your estate doesn't receive a tax receipt for the death benefit when paid. Your benefit comes from the tax receipt for the annual premium donation. For existing policies, you also can receive a donation receipt for up to the fair market value of the policy. However, tax rules may limit your claimable amount to the adjusted cost basis of the policy if you acquired it within 10 years before making the donation. We recommend you discuss this with your tax advisors if it applies to you. With existing policies, transferring the policy to your charity is a taxable disposition. This may create taxable income, but your charitable donation receipt will likely offset most of the taxes on this amount.

You can lower taxes at death when the charity is a beneficiary of your policy. Alternatively, you can lower taxes during your lifetime by transferring a policy to the charity and paying annual premiums. Both strategies provide you with tax savings, but at different times. Speak with your financial advisor and professional tax advisors to determine which option works better for you.

Donor advised funds

Donor advised funds (DAFs) are long-term charitable giving vehicles allowing you to donate money at any time. Adding money to a DAF provides an immediate donation receipt like donating cash or securities to a charity. DAFs work great for those who face a large tax bill in one year – for example on the sale of a business. In these situations, you want to lower immediate taxes but may not have enough time to think about which charities to benefit. DAFs allow you to delay the decision on which charities will get the donations and spread it out over time. The donated funds stay invested at your direction in a separate account. Once contributed, you don't have control over the money other than the investment choice and distribution to charity. DAFs are like private foundations as they serve similar functions. However, private foundations function in charitable planning where the donation amounts are larger.

Alternative minimum tax

Canada's tax system includes a secondary tax calculation for individuals known as alternative minimum tax (AMT). AMT works by limiting tax-preferred transactions like charitable donations. You may trigger AMT in a year you claim large tax deductions or credits compared to your income. Before making large donations, review the effect of AMT with your tax advisors. You may reduce or eliminate the effect through strategic planning over more than one year.

Corporate giving

Canadian businesses have similar tax incentives for making charitable donations. It is important to note that corporations do not get tax credits like individuals. Your corporation claims donations as allowable deductions to lower taxable income. The corporation benefits from reduced taxes based on the tax rate applicable to the corporation's taxable income. Like individuals, corporations can claim donations up to 75% of net income. Corporations can carry forward unused donations for 5 years for future use (20 years in Quebec if gift is made in a taxation year that ends after March 23, 2006).

Like individuals, your corporation can donate various assets and may benefit from unique planning opportunities. For example, if your corporation donates capital property, it can liquidate the asset and donate cash. Selling the underlying asset may attract capital gains tax which you can offset with the charitable donation deduction. However, the non-taxable portion of the gain credits your corporation's notional capital dividend account (CDA). CDA allows you to remove funds from your corporation as a tax-free capital dividend. If your corporation donates marketable securities in kind, it also benefits from the 0% inclusion rate mentioned above. The 0% inclusion rate gives your corporation a larger CDA credit and therefore can pay more tax-free capital dividends. You can find out more about the CDA in our article "Taxation of corporate investment income." Your corporation donates the same amount with drastically different tax results.

The bottom Line

Every Canadian has beneficiaries that may include family, friends, and charities. The government is an interested party in your estate through taxes. With careful planning, and using charitable giving strategies, you can help minimize taxes and increase amounts going to your chosen charities. Speak to your professional advisors when exploring charitable giving to ensure you are aware of the tax and legal consequences.