PLANNING MATTERS

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Charitable Giving in Tough Times

It is said that people are remembered not for what they kept, but for what they gave away. Philanthropy has become an important part of Canadian life, not just for our many charities, but also for our many donors. The Government of Canada has provided significant tax incentives to encourage philanthropy. The purpose of this piece is to provide a brief summary of these incentives and to encourage you to seek professional input before you decide to proceed with any of the strategies discussed below.

So why consider philanthropy now? After all, we are in the midst of a bear market and recession. It is for these reasons we feel the topic requires consideration. In recent years gifts to charities have increased, but after the bear market of 2008, future donations will likely decline. Where will charities turn for the necessary funds to maintain their programs and services? Their endowment funds have been hit hard and expenses haven't decreased. It is during times like these that charitable gifting is essential so they may carry on their good work.

Gifts of Cash

Charitable gifts no longer produce a simple tax deduction. The amount of the tax benefit has been increased to a fixed tax credit. Annual gifts totalling over $200 will produce tax credits based on the donor's highest marginal tax rate. In BC it is 43.7%.

This is a significant change. Under the old regime a gift of $10,000 would produce a deduction of $10,000. At an average tax rate of 32%, which is the total tax payable on a personal income of roughly $150,000, the tax savings would be $3,200. Now it is $4,370, which is an increase of 37%.

Gifts of Shares

There have been big improvements in the tax savings arising from gifts of publicly-traded shares. Formerly, your gift generated a tax deduction equal to the market value of the shares. From the tax savings you first had to cover any capital gains tax involved and only then could you apply the excess tax savings to other personal income. As capital gains tax is only one-half of the tax on income, there was always some tax savings arising from gifts of shares. The new rules have made gifting shares even more attractive.

Like gifting cash, the value of the shares generates tax credits instead of deductions. None of the credits have to be applied against any capital gains that have been made on the gifted shares, as the amount that has to be included in income is now zero. That means that all of the tax credits can be applied against other income. When you compare the tax cost of selling the shares, paying capital gains tax and then pocketing the balance, you will find that the net cost of donating shares, particularly those with large unrealized capital gains, has been reduced considerably.

Gifting Without Depleting Your Estate

You would like to donate publicly-traded shares to your favourite charity, but you would also like to have your children or grandchildren inherit that money. You can accomplish both with life insurance by using the tax savings from your donation to pay the cost.

On a $100,000 gift of shares, your tax credits will total $43,700 and your tax on any capital gains will be zero. In order to restore your estate, you deposit the entire $43,700 into a life insurance policy that will have a face amount of no less than $100,000 and will be designed to grow. Your full estate will be restored even though you have made a very substantial gift to your preferred charity (which now can include your private foundation). On your death, your estate will include the insurance amount plus the policy's growth. There will be no tax on the insurance payment, including the amount of the growth.

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Gifts of Life Insurance

A popular way of making legacy gifts is to donate a life insurance policy to the charity. The annual premiums that are paid by you generate tax credits for you to use every year, thus reducing the cost by almost one-half. Where you donate an existing policy that has a cash surrender value, you will receive an additional tax credit based on the amount of the value.

Gifts at Death

Many Canadians leave charitable legacies when they pass on. These can be cash, securities, insurance, real estate or other assets. Always seek professional advise on how to structure these gifts.

How a gift is made at death determines whether the tax credits can be used by the deceased taxpayer or by the estate of the deceased taxpayer. There is a huge difference. The terminal tax return is often the largest tax return any of us will ever file. This is where tax credits are usually needed most. Where the assets of an estate are to be distributed and the estate wound up, there is little need of tax relief for the estate. On the other hand, where the estate will be holding on to assets for a number of years, investing them and paying tax, the estate may well then have need for tax credits. Gifts made by Will must specify both the amount and the charity if the deceased is to benefit from the tax credits. If these factors are to be determined by the executor or trustee, the tax credits will then go to the estate.

Assets in the estate, including life insurance proceeds that are yet to be gifted, are all subject to probate fees. Tax credits available to the deceased can be used in both the year of death and the previous year, and gifts can total 100% of income, as opposed to the normal 75% allowable maximum. As there are a number of rules involved, it is important that you work closely with your financial advisor and your lawyer to ensure that any charitable tax credits go to the right place.

Annuities

The Charitable Gift Annuity has been a popular gifting concept for many years, but it's efficiency has been diminished due to recent tax changes. The same results can now be achieved by buying a prescribed annuity yourself, and gifting the taxable portion of the annuity each year. Annuities yield a higher-than-usual income because they return your capital as well as earn interest. The problem is that annuities are purchased with cash and thus, diminish your estate. As a result, the insured annuity, which replaces the annuity's cost at death, has become a very popular option for fixed income investing. The tax preferences built into this plan provide enough income to be able to insure the capital amount of the annuity and still produce a guaranteed high income for life. Donating some of the taxable portion of the annuity (the interest earnings) will yield sufficient tax credits to pay the tax on the balance which, when combined with the non-taxable portion (the return of capital) produces a better after-tax income than interest income, which may allow you to make annual charitable gifts without reducing the net income you have previously enjoyed.

Gifts by Corporations

When your company makes a gift, the amount of the gift is deductible from taxable income, and does not generate tax credits. It is therefore usually advisable to have your company pay the money to you in the form of a bonus, and for you to subsequently make the gift in your own name. Your average tax rate is likely to be well below the top marginal tax rate of 43.7%, which is the rate used for the tax credits. For example, approximately $48,000 of tax is payable on a taxable income of $150,000 (32%). Tax credits of 43.7% will therefore be more advantageous than deductions. Always consult your accountant before determining whether a gift should be made by you or by your company.

Summary

Thanks to our more generous tax laws, charitable gifting has less effect on your bottom line. Indeed, you may find that it is far less expensive and far more satisfying than you ever have imagined.

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