Tax Considerations for Charitable Gifting

Prepared by:
Martin Kretzschmann CPA CA
for Georgian Bay General Hospital Foundation
October 24, 2014

Ideas to Reduce Tax using Charitable Giving

- Simple Gift during life
- Bequests in Will
- Gift of Securities
- RRSP's
- Giving through Life Insurance
- Charitable Remainder Trust

General Rules - Donations

- For those in highest income tax bracket:
- 20% Tax Credit on first $200 of donation
- 46% Tax Credit on remainder

- Can claim donation credit on up to 75% of income
- Any unused credit carried forward 5 years

- Can claim against 100% of income in year of death
- Unused credit can be carried back to year prior to death

Simple Giving During Life

- Charitable giving during life is a good way to redirect cash otherwise sent to the CRA in the form of tax.
- Gifting to charities - your money can be used in ways that you approve of and for causes close to your heart.
- Make a plan on setting aside a certain amount each year and who to donate it to.
- Will reduce tax payable at the end of the year.
- For most people, giving $1,000 will save $400 in income tax.

Example – Simple Cash Donation

- Count Dracula- Income in highest tax bracket due to successful film career and foreign real estate holdings
- Wants to donate $10,000 to his favourite charity

Donation	$10,000
Tax Credit	$ 4,600
Net Cost of Donation	$ 5,400

- Charity receives $10,000 while cost to the Count to donate is only $5,400

Giving though Bequests

An Unfortunate Fact

- Everyone is Mortal *(excluding Vampires)*
- *"In this world nothing can be said to be certain, except death and taxes"*

Benjamin Franklin

Tax Consequences on Death

- Deemed Disposition of all of your assets at their fair market value on death
- Incur capital gains on appreciated investments – Stocks, Mutual Funds etc.
- Capital gains on other appreciated property – Cottage, Vacation Property
- Full value of RRSP's and RRIF's are taxed on final return

(Exception if surviving spouse - then assets can be transferred to spouse at cost)

Example – Taxes on Death

- Ichabod Crane – (Widower):

Income for part of the year up to death	$ 60,000
Gain on deemed disposition of Investments	$ 100,000
Gain on Sleepy Hollow Cottage property	$ 400,000
Value of RRIF's on Death	$ 440,000
Total Income on Final Return	**$1,000,000**
Income Tax payable	**$460,000**

- **Major Beneficiary of Estate = Canada Revenue Agency!**

Use of Bequests

- Naming a registered charity as a beneficiary in your will allows your Estate to reduce income tax on your final tax return with a donation credit.
- Can use donation credit of up to 100% of income on final return.
- Any unused portion can be carried back to apply to 100% of income in previous year.

Previous Example of Ichabod Crane

- If full estate was worth $3 million (incl. condo, life ins. etc)
- 1/3rd of his estate left to charity in his will
- = zero income tax payable for estate

Gift of Securities

Normally 50% of gain on sale of securities is taxable when sold/disposed

- Effective 2006 – CRA Eliminated capital gains on publicly traded securities donated to a charity
- Shares must be transferred directly to charity, who can then issue donation receipt for fair market value of shares
- Donor transfers securities from his/her brokerage account to the charity's brokerage account
- Donor pays no tax on sale, and gets charity receipt for full value
- Charity pays no tax on cashing in of securities
- Gifts can be given during lifetime or as bequest in will

Eventually securities need to be disposed – Deemed disposition on Death

Example – Gift of Securities

- Dr. Frankenstein owns shares in a successful publicly traded bio-genetics technology company.

- Cost of shares – $25,000
- Market value of shares - $125,000
- Gain of $100,000
- Taxable Capital Gain of $50,000 (50% of gain)

- <u>Donation of Cash</u>

Proceeds on Sale of Stock	$ 125,000
Add Tax Payable on Gain	23,000
Less Donation Credit	(58,000)
After Tax Cost of $125K Donation	**$90,000**

- <u>Donation of Securities</u>

Value of Stock Donated	$ 125,000
Tax Payable on Gain	-
Less Donation Credit	(58,000)
After Tax Cost of $125K Donation	**$67,000**

- **Charity receives $125,000 which only costs Dr. F. $67,000**

RRSPs and RRIFs

- On Death – full value of RRSP/RRIF added to income and fully taxable.
- Exception if transferred to surviving spouse.
- Person with $100,000 in RRSP - Estate may be left with only $54,000 to distribute after tax.
- Registered Charity can be named as beneficiary of RRSP/RRIF.
- Resulting donation tax credit will offset all tax generated by inclusion of RRSP/RRIF in income.
- Naming charity as direct beneficiary means RRSP/RRIF funds flow outside of will and not subject to probate.

Life Insurance

Several ways to structure gifting with life insurance.

1. **Assign ownership of a new or existing life insurance policy to a charity with the charity as the beneficiary**

- Donor continues to pay premiums
- Donor will be able to get donation credit for premiums paid during each year
- Can also get donation credit for cash surrender value if transferring an existing policy
- Charity will get the full insurance proceeds on your death.

Advantages

- Would be good for those who want an immediate tax benefit to apply against their income each year and who may not have a significant tax liability on their estate.

Disadvantage

- Estate would not get donation receipt for value of life insurance on death as ownership was transferred during life

Life Insurance

2. **Name the Charity as the beneficiary of an existing policy:**

- Donor continues to pay premiums
- On death, insurance proceeds paid to charity
- Donation receipt issued to estate for full value of proceeds which can be applied to deceased final return.
- Charity will get the full insurance proceeds on your death.

Advantages

- Owner retains flexibility to change beneficiary to another charity or other beneficiary during their life.
- Option to access cash surrender value is still there if needed during life.
- Attractive option for those individuals who may realize significant tax on their death.

Life Insurance

3. **Name the Estate as Beneficiary with a Testamentary Bequest of all or a portion of the Insurance proceeds to Charity:**

- Life insurance proceeds are not taxable on death
- Estate would get tax receipt for the full amount of donation
- Will reduce or eliminate tax generated from other income sources on the final return (e.g. Deemed capital gains, RRSP's etc)
- Retains flexibility for the donor to use life insurance as a general tool to go to donate to multiple charities on death

Charitable Remainder Trust

- Donor transfers property to a trust
- Names a charity as the capital beneficiary
- Donor (or heirs of donor) entitled income from the property during their life
- On death, residual capital paid to the charity
- Donor receives tax receipt on the transfer of property to the trust *(based on actuarial valuation of residual interest of trust)*
- Trust can be set up during life (inter-vivos) or through the will (testamentary)

Charitable Remainder Trust

Advantages

- Very flexible – donation receipt during life or on death depending on terms and type of trust
- Donor retains income generated from trust
- Usually set up through trust company – so donor not burdened with administration of trust
- Avoids probate fees
- Attractive to donors with significant assets but still require income from the asset or the income for an heir during their lifetime

Disadvantages

- Expensive to administer. Donor incurs ongoing costs.
- Irrevocable (can't change your mind after a couple of years)
- May be limited amount of charities agreeable given complexity of arrangement and time delay of actual proceeds to charity.

First Time Donor's "Super" Credit

- Additional credit for "first time" donors of 25% of new donations up to $1,000
- "First time donor" defined as taxpayer who has not (or spouse has not) claimed a donation credit since 2007 (5 years from 2013).
- Temporary credit – can be claimed only once starting in 2013 until 2017.
- First time Ontario donor gifting $1,000 would receive a tax credit of $611.
- Net cost of $1,000 donation to first time donor only $390.

Prepared by Martin Kretzschmann, CPA CA

Brabant & Kretzschmann, Chartered Professional Accountants

October 2014

Information contained is presented for general information purposes only.

Donors should seek professional advice regarding charitable giving that takes into account their specific situation.