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FINANCIAL ADVISORY SUPPORT

Charitable Donations of Securities

Gifting shares instead of cash could enhance your tax benefit

Gifting publicly traded securities

To encourage individuals to increase their charitable giving, there is a tax incentive for individuals who wish to donate publicly traded securities. These securities include shares, debt obligations or rights listed on a designated stock exchange, mutual funds, interest in related segregated funds and Government of Canada or provincial government bonds donated to charitable organizations, public or private foundations (hereinafter referred to as "charity"). The capital gains triggered upon the disposition of these donated securities is eliminated, resulting in lower income taxes.

Mechanics of the tax credit

When a donation is made to a qualifying charity, the donor is entitled to claim a tax credit on their personal tax return. Some examples of a qualifying charity are Canadian registered charities, Canadian universities, registered Canadian amateur athletic associations, certain universities outside of Canada and the United Nations. The tax credits reduce the amount of tax that the donor has to pay in a given year by reducing the federal and provincial taxes payable.

For the first $200 of donations being claimed, a non-refundable federal tax credit of 15% for 2010 will be granted. This means that the amount of federal tax payable will be reduced by $30. After the first $200 threshold is passed, any remaining donation amount being claimed on the tax return for that year will result in a non-refundable federal tax credit of 29%. Thus if an individual claims a total of $1,000 in donations, the first $200 will generate $30 in federal tax credits, while the remaining $800 will generate $232 in federal tax credits for a total of $262 in federal tax credits. Provincial taxes payable will also be reduced.

The net effect for taxpayers in all tax brackets is that the portion of the charitable donation in excess of the first $200 will result in a tax savings approximately equal to the top marginal tax rate (except in Alberta where the tax savings are at a 50% rate and the highest marginal tax rate is 39%).

The following table summarizes the highest marginal tax rates for the provinces for 2010:

Province	Donation tax credit for gifts over $200
British Columbia	43.7%
Alberta	50.0%
Saskatchewan	44.0%
Manitoba	46.4%
Ontario	46.4%
Quebec	48.2%
New Brunswick	43.3%
Nova Scotia	50.0%
Prince Edward Island	47.4%
Newfoundland and Labrador	43.4%
Yukon	42.4%
Northwest Territories	43.1%
Nunavut	40.5%

Combining the elimination of the capital gain and the donation tax credit

When you donate a security with accrued capital gains, then you benefit from the elimination of the capital gain plus the donation tax credit. The combined tax savings can be quite impressive. The following example illustrates this point by comparing two alternatives for donating securities, assuming a FMV of $50,000, an adjusted cost base (ACB) of $10,000 and a tax rate of 46%.

	Sell shares and donate cash	Donate shares directly
FMV of donation **(a)**	$50,000	$50,000
Adjusted cost base	$10,000	$10,000
Capital gain	$40,000	$40,000
Taxable capital gain	$20,000	$0
Tax on capital gain @46% **(b)**	$9,200	$0
Tax savings from donation tax credit **(c)**	$23,000	$23,000
Total cost of donation = (a) + (b) – (c)	**$36,200**	**$27,000**

This example demonstrates that there are tax savings to be realized by donating publicly traded securities with appreciated gains as opposed to first selling the publicly traded securities and then donating the proceeds. This means it costs you less to make a donation of securities instead of a donation of cash. In this example, a savings of $9,200 ($36,200 – $27,000) is realized by donating the appreciated property instead of selling it and donating the proceeds. **The difference is a direct result of the eliminated capital gains on the donated securities.**

Other strategies to maximize the tax benefit of donations

Several strategies may be combined with the elimination of capital gains on donated securities to enhance the tax benefits.

Donate some shares to eliminate tax on sale of securities

If you sell securities with an accrued capital gain, then you will most likely trigger a tax liability on the taxable capital gain. Donating the securities may be one alternative to eliminate the taxable capital gain. However, you may not wish to donate all the securities since you may want to reinvest the proceeds or use them for lifestyle expenses. In this case, you may want to donate a portion of your securities and sell the remaining portion.

You can use the donation tax credit on the portion of the securities that you donate to eliminate the tax liability on the capital gain triggered on the disposition of the remaining portion (i.e. portion not donated). This begs the question, what portion of my securities do I need to donate so the tax on the securities I sell will be eliminated?

Use the following formula to calculate the FMV of the shares you need to donate to eliminate the tax on the sale of the securities you retain:

FMV of Donated Securities = (FMV)(FMV – ACB)
(3FMV – ACB)

Here is an example to illustrate assuming the total FMV of the securities is $50,000 and the ACB is $10,000:

FMV of Donated Securities = ($50,000) x ($50,000 – $10,000)
(3 x $50,000 – $10,000)

FMV of Donated Securities = $14,286

The following table demonstrates the tax impact of selling the securities and keeping all the sale proceeds of $50,000 vs. donating $14,286 of securities and keeping the remaining $35,714 of sale proceeds:

	Sell Securities	**Donate a portion and keep the remaining sale proceeds**
FMV of securities **(a)**	$50,000	$50,000
Proceeds of disposition of securities not donated	$50,000	$35,714
Amount of charitable gift (*) **(b)**	$0	$14,286
ACB	$10,000	$10,000
Capital gain ($50,000 - $10,000)	$40,000	$40,000
Taxable capital gain	$20,000	$14,286 (**)
Tax on capital gain @46% **(c)**	$9,200	$6,571
Tax savings from donation tax credit **(d)**	$0	$6,571
Net tax liability	$9,200	$0
Net proceeds retained = (a) – (b) – (c) + (d)	**$40,800**	**$35,714**

(*) The donation amount is equal to the proceeds of disposition for the securities donated
(**) 50% of the capital gain on securities not donated = ($35,714 – $7,143) x 50% = $14,286. The ACB for the securities not donated is the prorated ACB as follows ($35,714/$50,000) x $10,000 = $7,143.
The taxable capital gain on the $14,286 securities donated is nil.

Based on this example, you could donate securities worth $14,286 at an out-of-pocket cost to you of $5,086 ($40,800 – $35,714). The donation tax credit of $6,571 would eliminate the tax on the capital gain of $6,571 on the securities that you sold, and thus you would have a net tax liability of zero. This is a great strategy to use to support a charity and keep a portion of the proceeds to reinvest or for lifestyle expenses.

Donating Flow Through Investments

The tax benefit of donating securities is enhanced when a mutual fund that was originally a flow through limited partnership unit is donated to a charity. When you invest in flow through limited partnership units, you are generally able to deduct expenses allocated by the flow through partnership up to a maximum of the amount paid for the flow through units.

For example, if you purchased flow through limited partnership units for $10,000, then you could receive deductions equal to $10,000 (possibly over two to three years). At an assumed marginal tax rate of 46%, this would generate a tax savings of $4,600. As a result, the ACB would be reduced by the amount of the deduction, which in our example would result in a zero ACB. After 18 to 24 months, many of the flow through limited partnership units would roll over on a tax-deferred basis to a mutual fund, which could then be sold. The mutual fund would have a zero ACB (rolled over from the flow through units). Upon disposition of the mutual fund, you would trigger a capital gain equal to its FMV. If you donated the mutual fund to a charity, you would benefit from the eliminated taxable capital gain and the charitable donation credit.

If you own limited partnership units that are not flow through units or if a taxable capital gain is triggered at time of converting the partnership unit to a security, then you may eliminate some or all of that capital gain triggered at time of conversion if you donate the security within 30 days of the conversion. Please consult with your tax advisor if the conversion of the partnership units results in a taxable capital gain and you wish to donate the new security received.

Here is an example that illustrates the cost savings of investing in flow through limited partnership units and donating the flow through mutual fund units instead of selling the mutual fund units and donating the cash proceeds. This example assumes the FMV of the units remains the same after the holding period has passed and assumes that the conversion from the partnership to the mutual fund was completed on a tax deferred basis.

	Sell flow through/mutual fund and donate cash	**Donate flow through/mutual fund directly**
Flow through acquisition **(a)**	$50,000	$50,000
Deductions claimed	($50,000)	($50,000)
Tax savings @ 46% **(b)**	$23,000	$23,000
FMV of donation	$50,000	$50,000
Adjusted cost base	$0	$0
Capital gain	$50,000	$50,000
Taxable capital gain	$25,000	$0
Tax on capital gain @ 46% **(c)**	$11,500	$0
Tax savings from donation tax credit **(d)**	$23,000	$23,000
Total cost of donation = (a) – (b) + (c) – (d)	**$15,500**	**$4,000**

It is important to note that flow through limited partnership units do not trade initially on a prescribed stock exchange and hence will not qualify for the eliminated capital gains treatment if they are donated. Typically to receive the favourable tax treatment, you have to wait until the flow through limited partnership units are converted into a mutual fund, and then you can donate the mutual fund units in kind.

It is also possible to benefit from the deduction of flow through expenses by buying flow through common shares. If you as the shareholder buy newly issued shares, these special common shares will result in an immediate reduction of the ACB to zero and an entitlement to future deductions for a number of years. If then these flow through common shares are donated, their FMV will result in a donation tax credit, and the taxable portion of the capital gain will be eliminated.

However, given the unique characteristics of these shares, the original shareholder will be able to continue to deduct the flow through expenses for a number of years. These benefits are only available when the common shares are newly issued by qualifying corporations. The price paid for the newly issued shares is higher than their FMV immediately afterwards since a premium is paid for the flow through deduction. Therefore, the value of the donation tax credit on the common shares donated will be lower than the price paid for them.

If you are considering donating flow through shares/units, please consult your tax advisor and the charity you intend to make the gift to in order to ensure that the tax treatment just discussed is applicable to your scenario and legislation has not changed or been amended. If you are considering purchasing flow through shares/units through a promoter where you are ultimately required to donate the flow through shares/units, please consult your tax advisor and the charity to find out if this would be considered a gifting arrangement that may impact you and the charity negatively.

Donating Shares Acquired Through Employee Stock Options

The favourable tax treatment concerning the donation of securities extends to the donation of stocks acquired through employee stock options when the securities are donated to a charity. When stock options are exercised, a taxable employment benefit is generated, equal to the difference between the FMV on the day of exercise and the exercise price.

The taxable benefit may be reduced by a 50% stock option deduction if certain conditions are met. If the securities are donated to a charity in the same year of exercise and within 30 days of exercise, then an additional 50% deduction is permitted and the whole taxable benefit is eliminated. The FMV of the securities also generates a donation tax credit.

Note that if you have a cashless exercise, where you exercise your options but direct a broker that your employer uses to immediately sell the stock and donate the sale proceeds to a charity in the same year of exercise and within 30 days after exercise, then you will also be eligible to eliminate all or a portion of the taxable stock option benefit.

Donating Exchangeable Shares

As a result of a reorganization of shares or a sale of shares to a foreign acquirer, you may have acquired exchangeable securities in order to allow you to defer the capital gains on the disposition of your securities. These exchangeable shares are generally not publicly traded, but they may be exchanged for publicly traded securities. When you exchange your exchangeable shares for publicly traded shares, a deemed disposition will occur and a capital gain/loss will be triggered. The capital gain triggered on the conversion will be eliminated if the converted publicly traded securities are gifted to a registered charity within 30 days of the exchange. At the time the unlisted security is issued, it must be exchangeable for the publicly traded security, and the publicly traded security must be the only consideration received on exchange.

Donating Depreciated Securities In Kind

Donating appreciated securities is attractive for tax purposes as the capital gain is eliminated; however, during times of a market downturn, donating depreciated securities may also be considered. Year-end tax planning often involves tax loss selling and charitable giving as two popular strategies that may be used to reduce your tax bill. Combining the two strategies is possible as in-kind donations of depreciated securities trigger a capital loss for tax purposes and result in a donation tax credit equal to the FMV of the security donated. The capital loss triggered is **not** eliminated; it is applied first against any capital gains realized in the same year. Any remaining net capital losses can then be carried back and applied against capital gains from the previous three years, or they can be carried forward and applied against capital gains realized in the future.

Donating RRSP/RRIF Assets vs. Non-Registered Securities In Kind

It is possible to donate the assets in your registered account to a charity during your lifetime or upon death. However, the assets in your registered account will not benefit from the eliminated capital gains treatment as the value of the assets is considered income on your tax return, not a capital gain. As a result, assets paid out of a registered plan to a charity are considered an income inclusion equal to the FMV and will result in a donation tax credit equal to the FMV.

If you are considering donating a certain amount of funds and you are considering whether to donate from your registered account or make a donation in kind using your non-registered assets, then you should consider making the donation in kind as it will eliminate your capital gain and result in a donation tax credit that will reduce your taxes payable. Your tax savings will equal the amount of tax saved on the eliminated capital gain.

Establishing a Charitable Foundation

If you have thought about leaving a legacy and you are wondering about the best way to do this for yourself and your family, you may wish to consider establishing your own foundation through the RBC DS Charitable Gift Program. You can establish a foundation with a customized name (i.e. The Smith Family Foundation) and make annual donations to the foundation. The foundation then will make grants to a charity or charities of your choice in the name of your foundation. You can take advantage of the eliminated capital gain rules and leave a legacy by donating shares to your own charitable foundation.

Combining Charitable Donation Tax Credits

Charitable donation receipts made out to one spouse may be used on either spouse's tax return. This may present an opportunity where several donations can be collected together to maximize the amount of the tax credit at the top marginal tax rate.

Maximum Tax Credits

For most types of donations, an individual can claim charitable contribution tax credits equal to a maximum of 75% of net income in a taxation year. Where donations are made in the year of death, this limit is raised to 100% of net income. If there are excess unused credits in the year of death, then the preceding year's tax return can be re-filed to also claim a tax credit of up to 100% on that year's net income.

The ability to claim a tax credit equal to 100% of net income in the year of death may be advantageous for individuals who plan to donate their RRSP or RRIF to a charity upon their death. The tax credit for the charitable contribution could offset the income inclusion that will result upon the deemed deregistration of the RRSP or RRIF. That is, an RRSP/RRIF income inclusion will generally be taxed at the top marginal tax rate on a terminal tax return, but this can be offset by the RRSP/RRIF donation tax credit, which is also at the top marginal tax rate.