Reference Guide

CHARITABLE GIVING

WEALTH PLANNING GROUP

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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, resulting in a lower income tax bill.

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 bill 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.

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 $200,000 or less of taxable income, and 33% of the amount of the gifts over $200 for donors with more than $200,000 of taxable income.

There is also a temporary First-Time Donor's Super Credit available for a donation made by a first-time donor, which provides an extra one-time 25% donation tax credit for the first $1,000 donated between March 20, 2013 and December 31, 2017. An individual is considered to be a first-time donor if neither the individual nor the individual's spouse or common-law partner (if applicable) has claimed and been allowed a donation tax credit for donations made after 2007.

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 will 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 of which body ordinarily includes students from Canada
- Her Majesty in right of Canada, or a province or territory, or
- a registered foreign charitable organization to which Her Majesty in right of Canada has made a gift.

If obtaining a charitable tax credit is important, it is advisable to review with a professional whether or not 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 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 – FORMER RULES

Before January 1, 2016, charitable gifts made by no will were deemed to have been made in the final year of life, so the charitable tax credit could be used to reduce taxes in the deceased’s tax return for that year. Special rules in the Act provided for an enhanced donation limit in the year of death and an opportunity to reduce taxes for the year prior to death. These rules can be summarized as follows:

- For gifts made in the final year of life, including gifts made by will, the limit increased from 75% of the donor’s net income to 100% of the donor’s net income.
- If the gifts made in the year of death or by will exceeded 100% of the donor’s net income for that year, the excess amount of the gifts is deemed to have been made in the preceding year, and the limit for that prior year is also increased to 100% of the donor’s net income. The result of this “carryback” is that significant donation amounts could be used to reduce taxes not just in the year of death but also for the year prior to death.

Note that where a donation is made by will, certain requirements had to be met under the former rules in order to be able to claim the donation tax credit and to take advantage of the carryback outlined above. For example:

- the will must clearly provide for the donation of a specific property or dollar amount or a certain percentage of the residue
- it should be clear in the will that the trustee must make the donation; and
- the donation must be made to an eligible charitable organization, as described earlier.

While the CRA had indicated that it may be possible to allow the trustee to select which charity or charities should benefit (but not the amount of the gift), it was generally advisable to name the intended charities in the will, using their proper legal names.

Proper ways to make a charitable gift by will included:

- Setting a fixed dollar amount for the gift (keeping in mind the size of the gift in relation to the total expected value of the estate).
- Describing the amount of the charitable gift as a proportion or percentage of the residue of the estate, provided that its value is not subject to any discretionary powers of the executors that could in any way reduce the amount of the gift.
- Establishing a testamentary trust for the benefit of one or more individuals, with a charity to benefit once the individuals have died, provided that the trustees of the trust are not able to encroach on the capital of the trust by making payments of capital to or for the benefit of the individual beneficiaries. This is because an ability to encroach on capital means that the actual amount of the ultimate gift to the charity is uncertain, since the gift could be significantly reduced if any capital encroachments are made. Accordingly, if, for example, the will establishes a trust for a family member for life, with the capital to be given to a charity on the family member's death, this would be acceptable as long as the trustees of the trust cannot use or pay out any of the capital for the family member (or others) while the family member is alive.

Where the specific requirements noted above were not met, so that the charitable gift did not qualify as a gift "made by will", it was still possible that the estate, which is a trust for tax purposes, would receive a charitable donation tax credit, but the credit would not be available for the deceased's final tax return and the carryback would not apply. The potential tax credit available was therefore diminished.

LIMITS TO DONATIONS MADE BY WILL – RULES AS OF JANUARY 1, 2016

Effective January 1, 2016, new 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 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.

The same donation tax credit limits described above continue to apply under the new rules. However, under the new rules, executors have increased flexibility to allocate gifts made 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 estate is designated as the "graduated rate estate" of the individual
- no more than 36 months have passed after the individual's death.

New proposals released by the Department of Finance on January 15, 2016 extend the window of application of the foregoing rules to 60 months, where gifts are made by a former qualifying estate that is no longer qualifying only because the 36 month period after the individual's death has passed (but the estate continues to meet the other conditions). If implemented, these proposals combined with the existing rules would mean that gifts made by a former qualifying estate within 60 months after the individual's death can be allocated among:

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

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 lifetime, a Canadian resident donates a property in 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 $12,075 (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 $9,203.

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 $23,497 (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 $5,475 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.

The 2008 federal budget broadened these rules further to apply to gains realized on the exchange of certain unlisted securities that are shares or partnership interests for publicly traded securities, provided certain conditions are met.

Currently, these special rules also 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. Effective January 1, 2016, these special rules will apply where a gift of securities is made by a qualifying estate.

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.

The 2015 federal budget has proposed to extend the capital gains tax exemption for qualifying securities with respect to donations of private corporation shares. The budget proposal indicates that the exemption will apply where cash proceeds from the sale of private corporation shares are donated to an eligible charity within 30 days of the sale and the purchaser of the shares is at arm's length with both the donor and the charity to which the cash proceeds are donated.

GIFTS OF REAL ESTATE

Similar to donations of private shares, the 2015 federal budget has proposed to extend the capital gains tax exemption for qualifying securities with respect to donations of real estate. The budget proposal indicates that the exemption will apply where cash proceeds from the sale of real estate are donated to an eligible charity within 30 days of the sale and the purchaser of the real estate is at arm's length with both the donor and the charity to which the cash proceeds are donated.

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. As noted earlier, under the former rules, this could be applied to reduce taxes payable in the year of death and in the immediately preceding year (subject to the 100% net income limit applicable to each of those years). As of January 1, 2016, 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 in the manner provided for under the new rules, 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. Proceeds of RRSPs, RRIFs and TFSAs, or life insurance that are designated, and paid, directly to a charity were formerly considered to be a charitable gift made by the deceased in his or her final year. This made the charitable donation tax credit available, as well as the opportunity to "carryback" excess donations to the year prior to death. Effective January 1, 2016, the executor has increased flexibility to allocate the donation tax credit in respect of gifts made by beneficiary designation in the manner provided for under the new rules, 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.

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 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 be donated 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.

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 (which are outlined in a separate reference guide), 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 schemes. 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.

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