RBC Wealth Management Services

The Navigator

Kentris Financial Group
RBC Dominion Securities

17 King Street East, 3rd Floor
Oshawa, ON L1H 7M9
Tel: (905) 434-6010
Fax: (905) 436-5068
kentris.group@rbc.com

www.kentrisfinancial.com

Charitable Donations of Securities

Gifting shares instead of cash could enhance your tax benefit

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.

The content in this article is for information purposes only and should not be taken as tax or legal advice. Prior to implementing any strategy, it is essential that you discuss your situation with a qualified tax or legal professional.

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% 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%).

Combining the Elimination of the Capital Gain When Donating Securities and the Donation Tax Credit

When you donate a publicly listed security with accrued capital gains, 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:

$$\text{FMV of Donated Securities} = \frac{(\text{FMV})(\text{FMV} - \text{ACB})}{((3\text{FMV}) - \text{ACB})}$$

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

$$\text{FMV of Donated Securities} = \frac{(\$50{,}000) \times (\$50{,}000 - \$10{,}000)}{((3 \times \$50{,}000) - \$10{,}000)}$$

FMV of Donated Securities = $14,286

The table on the following page 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:

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 upport a charity and keep a portion of the proceeds to reinvest or for lifestyle expenses.

	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.

Donating Flow-Through Investments

In 2011, the federal government introduced new rules to limit what they saw as excessive tax benefits that resulted from the elimination of the taxable capital gains on the donation of flow-through securities by effectively taxing the portion of any capital gain up to the original cost of the shares. As a result of these new rules, a deemed capital gain may be triggered when flow-through securities are donated. These new rules apply to donations of a "flow-through share class of property" made on or after March 22, 2011. However, the new rules do not apply to flow-through common shares acquired before March 22, 2011 or mutual fund corporation shares that are received in exchange for flow-through limited partnership units acquired before August 16, 2011 (no contributions to the partnership can be made on or after August 16, 2011).

For more information on donating flow-through investments, please ask your RBC advisor for the article titled "Flow-Through Shares and Limited Partnership Units".

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 the 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 Charitable Gift Program. You can establish a foundation with a customized name (e.g.. 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.

For more information on the RBC Charitable Gift Program speak with your RBC advisor.

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 amended 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.

Please contact us for more information.

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