INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

RBC Wealth Management

Aaron Fennell, MBA, CFA
Investment Advisor
aaron.fennell@rbc.com
416-313-6397

RBC Wealth Management
181 Bay Street, Suite 2350
Toronto, ON M5J 2T3
www.aaronwfennell.com
866-605-3295

Charitable donations of securities

Gifting shares instead of cash could enhance your tax benefit

To encourage charitable giving, the government provides you with a tax credit when you make a donation to a registered charity. This donation tax credit can be used to reduce your taxes payable. A further tax benefit is provided if you donate certain securities in-kind. This article discusses the tax benefit of donating publicly traded securities in-kind.

Gifting publicly traded securities

Generally, when you gift property, the property is deemed to have been disposed of at fair market value (FMV). As such, you may realize taxable capital gains if the property has increased in value since you first acquired the property. The capital gains triggered when donating securities may be eliminated in some cases if you donate the securities in-kind.

In order to qualify for the elimination of capital gains, the donated securities can be:

- shares, debt obligations or rights listed on a designated stock exchange;
- mutual funds;
- interest in related segregated funds; or
- Government of Canada or provincial government bonds.

In addition, the donation must be made to a qualified donee. The term qualified donee refers to an organization that can issue donation receipts for the gifts they receive from individuals or corporations. Qualified donees may be charitable organizations, public foundations or private foundations. Typically, a registered charity is a qualified donee. In this article, the terms qualified donees and registered charities are used interchangeably.

The Canada Revenue Agency (CRA) maintains a list of qualified donees who may issue official donation receipts for gifts. You may check their website for the current tax status of your favourite charity.

Before making a donation in-kind, it is important to contact the qualified donee and verify that they can accept in-kind donations.

Mechanics of the donation tax credit

When you make a donation to a registered charity, you can choose to claim a tax credit on your personal tax return. The donation tax credit reduces your federal and provincial income taxes in the year you make

Federally, there are three levels of tax credits that may be available to you depending on your taxable income and the amount of the donation.

the claim. You do not have to claim the donation tax credit in the year you make the donation. You may carry forward unclaimed donations for five tax years. If you make small annual donations, you can claim the combined donations to utilize the higher credit for gifts above $200 in a future year.

The donation tax credit is non-refundable which means the tax credit cannot reduce the amount of your tax below zero. Federally, there are three levels of tax credits that may be available to you depending on your taxable income and the amount of the donation. The table below illustrates how you calculate your donation tax credit.

	First $200 of donations	For individuals who are not subject to the highest federal tax bracket of 33%	For individuals who are subject to the highest federal tax rate of 33%
Federal Donation Credit	Federal tax credit of 15%.	Any excess donation over $200 will result in a tax credit of 29%.	33% on the lesser of: • The amount by which the individual's total gifts for the year exceed $200 and • The amount by which the individual's taxable income exceeds the dollar threshold for the top personal rate and 29% on the individual's total gifts for the year above $200 that is not eligible for the 33% rate above.
Example	An individual claims $200 in donations. This will provide them with a federal tax credit of $30 ($200 x 15%).	An individual claims a total of $1,000 in donations. The first $200 will generate a $30 federal tax credit, while the remaining $800 will generate a $232 federal tax credit for a total of $262 ($200 x 15% + $800 x 29%).	An individual has taxable income of $215,000 and makes a charitable donation of $20,000, their tax credit would be calculated as follows: • $30 (15% x $200); plus • $4,950 (33% x $15,000), which is the lesser of $19,800 ($20,000–$200) or $15,000 ($215,000–$200,000*); plus • $1,392 (29% x $4,800), which is calculated as $20,000–$200–$15,000. Overall this will provide them with a $6,372 federal donation tax credit.

* We assume in this example that taxable income above $200,000 is subject to the top federal income tax rate of 33%.

In addition to the federal tax credit illustrated above, you may also receive a provincial donation tax credit. The amount of the credit will vary depending on your province of residence. If you currently live in a province that has a surtax (currently Prince Edward Island and Ontario have a surtax), the donation tax credit will reduce your taxes payable which will reduce your surtax payable.

Limit on donation amount

There is no limit to the amount you can donate in a year. However, for tax purposes, you can generally only claim a charitable donation of up to 75% of your net income in a taxation year. The limit is 100% of your net taxable income for Quebec. This limit is also raised to 100% of net income in the year of death and the preceding year.

For example, assume Jane's net income for the year is $100,000. She received a large inheritance in the same year and decides to make a donation of $200,000 to her favourite charity. Jane will only be able to claim a maximum of $75,000 (75% x $100,000) of donations for tax purposes this year. Jane can carryforward the remainder for a maximum of five years.

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 tax plus the donation tax credit. The combined tax savings can be notable. The following example illustrates this point by comparing two alternatives for donating securities with a FMV of $50,000, an adjusted cost base (ACB) of $10,000. The donor's combined federal and provincial marginal tax rate is 46% and the donor is also entitled to a combined federal and provincial donation tax credit at a rate of 46%.

When you donate a publicly listed security with accrued capital gains, you benefit from the elimination of the capital gain tax plus the donation tax credit.

	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**

You may realize tax savings by donating publicly traded securities with appreciated gains as opposed to first selling the publicly traded securities and then donating the proceeds. It may cost you less to make a donation of securities than make a donation of cash. In this example, you realize a savings of $9,200 ($36,200 – $27,000) by donating appreciated property instead of selling it and donating the proceeds. **The difference is a result of the eliminated capital gains tax on the donated securities.**

You may be able 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.

Other strategies to maximize the tax benefit of donations

You may be able to combine several strategies with the elimination of capital gains on donated securities to enhance the tax benefits of making charitable gifts.

Donate some shares to eliminate tax on sale of securities

If you sell securities with an accrued capital gain, you may trigger a tax liability. As an alternative to selling the securities, you may want to consider donating the securities to eliminate the taxable capital gain. If you plan to use some of the sale proceeds to fund lifestyle expenses or make reinvestments, you may only want to donate a portion of the securities you are planning to sell and sell the remainder.

You may be able 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 to eliminate the tax on the securities I sell?

To estimate the FMV of the shares you need to donate to eliminate the tax on the sale of the remaining securities, you can use the following formula:

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

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 following table illustrates 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 (*) ($50,000 – $35,714) **(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 calculated as follows ($35,714/$50,000) x $10,000 = $7,143. The taxable capital gain on the $14,286 securities donated is nil.
*** Note that the example above assumes the individual receives a donation tax credit that is equal to their marginal tax rate of 46%, this is not necessarily the case and varies based on the province of which they reside and federal tax bracket of the individual.

The favourable tax treatment concerning the donation of securities extends to the donation of stocks acquired through exercising employee stock options when the securities are donated to a qualified donee.

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. You can use this strategy to support a charity and keep a portion of the proceeds from the sale of your securities for personal use.

Donating flow-through investments

In 2011, the federal government introduced 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. Generally, these rules tax the portion of any capital gain realized on the sale of the flow-through securities up to the original cost of the investment. As a result, a deemed capital gain may be triggered when flow-through securities are donated. These rules apply to donations of a "flow-through share class of property" made on or after March 22, 2011. However, these 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 exercising employee stock options when the securities are donated to a qualified donee. When you exercise your stock options, you receive a taxable employment benefit which is equal to the difference between the FMV of the shares on the day of exercise and the option exercise price.

If you exercise employee stock options and donate the acquired shares to a qualified donee, the employment benefit inclusion may be eliminated. If you qualify for the normal 50% stock option benefit deduction, you may receive an additional 50% deduction against the stock option benefit if the shares are donated. To be eligible for this tax treatment, you must donate the shares acquired from the exercise in the year the options were exercised and within 30 days of exercising. Furthermore, the shares donated must be ordinary common shares and the exercise price (i.e. employee's cost) to acquire the share must be no less than the FMV of the share at the time the option is granted. In addition to eliminating or reducing the tax on the stock option benefit, you will also receive a donation tax receipt equal to the FMV of the shares donated. You can use this donation receipt to reduce the tax payable on other taxable income.

If you use the cashless exercise method of exercising your stock options, 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

If you name the charity as a beneficiary of your registered assets or donate the registered assets through your Will, your legal representative may have the ability to claim a tax credit equal to 100% of your net income in the year of death.

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. In addition, 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 you can eliminate the capital gain. However, during times of a market downturn, you may consider donating depreciated securities. Year-end tax planning often involves tax loss selling and charitable giving as two strategies that may be used to reduce your tax bill. Combining the two strategies is possible as an in-kind donation of depreciated securities will 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 a future year. You should be mindful of the "superficial loss" rules if you are planning to repurchase the security. These rules are complex and beyond the scope of this article. Please ask your RBC advisor for the article titled "Superficial loss rules and planning strategies".

Donating registered assets vs. non-registered securities in-kind

You may donate the assets in your registered account, such as your RRSP/RRIF to a qualified donee 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. Assets paid out of a registered plan to a qualified donee results in an income inclusion to you equal to the FMV of the assets withdrawn and a donation tax receipt equal to the FMV donated.

If you name the charity as a beneficiary of your registered assets or donate the registered assets through your Will, your legal representative may have the ability to claim a tax credit equal to 100% of your net income in the year of death. This may be advantageous because the donation tax credit for the charitable contribution could offset the income inclusion resulting from the deemed deregistration of the RRSP or RRIF upon death.

Establishing a charitable foundation

If you have thought about leaving a legacy and you are wondering about the ways to do this for yourself and your family, you may wish to consider establishing your own private foundation. Alternatively, you can choose to make a donation using the RBC Charitable Gift Program. Through the RBC Charitable Gift Program, you can establish a charitable gift fund with a customized name. You can donate cash or other assets to the gift fund which is administered the Charitable Gift Funds Canada Foundation, a registered public foundation. The foundation will make grants to a charity or charities of your choice in the name of your fund. You can take advantage of the eliminated

If you plan on making a donation, have your RBC advisor review your portfolio to determine if there are any securities with large capital gains.

capital gain rules and leave a legacy by donating publically traded shares to your own charitable gift fund. For more information on the RBC Charitable Gift Program speak with your RBC advisor.

Conclusion

Making charitable donations provides individuals with a chance to give back to their community and receive tax incentives at the same time. When you donate publicly traded securities, in addition to getting a donation tax receipt for the FMV of the securities donated, any capital gains you have accrued on the donated securities may also be eliminated. If you plan on making a donation, have your RBC advisor review your portfolio to determine if there are any securities with large capital gains. Speak with your qualified tax advisor to determine whether it makes sense for you to donate securities with accrued capital gains.

This article may contain several strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal or tax advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax and/or legal advisor before acting on any of the information in this article.

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