



# Charitable giving

Cash is always good, but there are many ways for clients to support their favourite causes.

Whether clients are interested in donating now or through their will, with a little help from their financial advisor, they can not only exercise their benevolence, but provide for their own needs and reduce their taxes at the same time.

The following article discusses:

- Tax affect of cash donations
- Tax affect of donating securities
- Bequests through will
- Beneficiary designations to charities
- Immediate gift of a life insurance policy
- Deferred gift of a life insurance policy
- Charitable gift annuities
- Charitable remainder trusts
- How registered investments are donated

## Tax effect for cash donations

Cash gifts are probably the easiest way to support a charity. Most charities issue receipts for amounts \$10 and over.

Donors should report all donations in the tax return for the year the gift is made, even if the total gifts exceed the annual claim limit. This will help you track carry-forward amounts and minimize the risk of lost receipts. The *Income Tax Act (Canada)* allows donors to carry forward donations in excess of the annual limit in any of the five succeeding years. CRA allows either spouse to claim all donations on one tax return. (This is because the tax calculation for donations carries equal value no matter what tax bracket the taxpayer is in.)

Since the tax credit is non-refundable, taxpayers won't receive a refund of the difference if the credit exceeds the year's limit. But, they can claim any excess in any of the subsequent five years. (This carry-forward expires when the donor dies.)

Donors can claim an annual tax credit for donations up to 75 per cent of their net income. The 75 per cent limit does not apply to gifts made in the year of death and the limit increases to 100 per cent of the taxpayer's income for the year of death as well as the preceding year.

## Tax effect of securities donations

Since 1997, gifts of qualifying securities are only subject to *half* the capital gains inclusion rate. That means individuals and corporations are currently only required to include 25 per cent of the capital gain from these gifts in their income, so they only pay income tax on that portion. There are two qualifications to this rule. It does not apply to gifts made to private foundations. Also, gifts must be of shares, bonds or rights as listed on prescribed stock exchanges, shares of mutual fund corporations, units of mutual fund trusts or interests in segregated funds. The actual securities must be given to the charity.

The donor would receive a tax receipt from the charity for the fair market value of the securities on the date the gift was made.



## What's available in planned giving options?

Some charities may have staff trained to explain the available options and help select the one that best suits the client's circumstances.

The options explained below may not all be administered by all charitable organizations but they are the ones most frequently encountered.

### **Bequests through a will**

Charitable donations made through a will are deemed made in the year of death and the estate can claim them on the deceased's final tax return. One method is to set up a life insurance policy with the beneficiary being the estate. The will would direct that funds equal to the death benefit be donated to a charity. But a downside is that probate fees apply to the gift.

### **Beneficiary designations to charities**

Your client may want to designate a charity as the beneficiary of a life insurance policy or a registered retirement income fund (RRIF) or registered retirement savings plan (RRSP). Policyholders of an insurance policy (including policies and annuities registered as an RRSP or RRIF) can designate a charity as a beneficiary and when the policyholder dies, the charity receives the proceeds. The deceased's estate owes the taxes for any registered funds and the estate receives a charitable tax credit.

Note that the policyholder will have to be the life insured or the annuitant of the contract for this proposed change in the law to apply. Insurance proceeds will bypass the estate when policyholders designate the charity as beneficiary so probate fees are not payable.

This gives clients flexibility in planning their estate by taking advantage of available tax credits to minimize their tax liability at death.

### **Immediate gift of a life insurance policy**

Normally, donors will contribute whole life policies with cash surrender values. The size of the tax credit generated by such gifts depends on the client's age and health. A reasonably small outlay could fund a very large payment at death, if this option was initiated late in life.

To donate an existing policy, transfer the ownership of the policy to the charity and name the charity as the beneficiary. Unlike the bequest option discussed above, this transfer of ownership cannot be changed. The donor receives a donation tax receipt for the cash surrender value and any accumulated dividends and interest, less any outstanding policy loans at the time the ownership transfer is made. On the death of the life insured, the charity receives the proceeds directly. They are not subject to probate in the deceased's estate due to the process of changing the ownership.

The transfer of ownership is a taxable disposition, so the donor is liable for tax on the difference between the surrender value and the adjusted cost basis of the policy. Normally, the tax credit from the donation receipt will more than offset the tax liability that was created.

If donors continue to pay the policy premiums, they'll receive charitable donation receipts from the charity.

Another option is to set up a new policy where the charity is named as owner and beneficiary. In this situation, the government will base the tax credits on the premiums paid.

### **Deferred gift of a life insurance policy**

Donors can name a charity as beneficiary of a life insurance policy without changing the ownership from their own name. When the insured donor dies, the charity receives the death benefit directly without being subject to probate in the deceased donor's estate.

Since policyholders may change the beneficiary designation on demand, they won't receive tax credits during their lifetime. Donations made via beneficiary designation qualify for tax credits in the year of death and the prior year, and is retroactive for deaths back to 1999.



### **Charitable gift annuities**

Charitable gift annuities are irrevocable annuities that charities can either issue themselves or buy from insurance companies. Clients can use them to give a lump sum to a charity and receive a periodic income on which they may pay tax. The annuities must be set up with accrual tax reporting to the owner (the charity). Prescribed Annuity Contract (PAC) treatment is not available. However, this will not matter to the charity because it will not be required to pay taxes on the T5 slips it receives.

For annuities issued before Dec. 21, 2002, if the amount paid for the annuity exceeds the sum of the expected annuity payments, the CRA views the difference as an immediate gift. The donor is then entitled to a charitable donation receipt for the excess from the charity. The payments to the donor are tax-free annuity payments. This type of payment has no impact on the various clawbacks and income tests for government benefits since the payments are essentially a return of capital. The tax slips we issue go to the owner (the charity), not the annuitant who made the donation (the client).

Where the expected annuity income *exceeds* the annuity purchase price, there is *no* charitable donation. Each fixed payment is a blend of capital (that is returned tax-free) and a taxable interest portion. Naming a charity as beneficiary ensures the charity receives a donation if the annuitant dies within the guarantee period.

For more information on these annuities, see CRA's interpretation bulletin IT-111R2 outlining the operation of a charitable annuity:

For annuities issued after Dec. 20, 2002, the CRA has proposed new rules, which are slightly different. Where an amount is contributed to a charitable organization by a donor and the advantage received by the donor is a stream of guaranteed payments for a period of time (an annuity), the eligible amount of the donation will be equal to the excess of the amount contributed by the donor from the amount that would be paid to a third-party to acquire the annuity.

#### **For example:**

- Donor makes \$100,000 contribution to a charitable organization
- Donor's life expectancy is eight years (assume donor lives eight years)
- Donor is to be provided annuity payments of \$10,000 per year (total \$80,000)
- Cost of annuity to provide \$80,000 over eight years is \$50,000

#### **Tax treatment for annuity issued before Dec. 21, 2002**

- Donor receives tax receipt for \$20,000 (\$100,000 minus expected payments of \$80,000) for the year of donation
- Donor receives in total \$80,000 in annuity payments tax-free

#### **New Tax treatment for annuity issued after Dec. 20, 2002**

- Donor receives tax receipt for \$50,000 (\$100,000 minus \$50,000 cost of annuity) for the year of donation
- Donor receives in total \$80,000 in annuity payments, of which \$30,000 will be included in income over eight years (further details are being sought from the CRA)

### **Charitable remainder trusts**

Charitable remainder trusts may be standard in the United States, but they are not yet routine in Canada. They are an irrevocable *inter vivos* trust, established by a donor making a contribution. The charity is named as the trust's capital beneficiary and the donor, while alive, receives the trust income and pays the income tax resulting from that income. After the death of the donor, the remainder of the trust assets passes directly to the charity that was named as beneficiary. Such trusts can be set up to go to the charity only after the death of the last spouse.

A lawyer who specializes in estate planning should establish these trust instruments. Donors should consult prospective beneficiaries to ensure they are able to accept this type of gift.



In our business, a segregated fund contract may be an asset of a charitable remainder trust. There may be a capital gains tax liability created by the deemed disposition of an existing asset when transferred to the trust, but the tax credit generated may help offset the taxes owing.

The amount of the tax credit increases with the age of the donor. Clients in their 80s may receive a tax credit for as much as 70 per cent of the value of the gift. Every year, the client continues to receive the income generated by the trust and pays income tax on that income. The capital, however, stays intact and goes to the charity (as capital beneficiary) upon the death of the client, bypassing probate.

Another advantage to a charitable remainder trust is that it may serve to protect privacy and avoid possible will challenges. The same advantages exist for life insurance policies that name the charity as the beneficiary.

### **Charitable mutual funds are not available in Canada**

Although you may have heard about charitable mutual funds, they are not available in Canada.

The Charitable Gift Fund offered by Fidelity, perhaps the largest mutual fund company in the United States, actually receives the third largest amount of charitable donations in that country. It, and similar funds, allow taxpayers to convert appreciated assets into tax breaks and help the less fortunate at the same time.

An American taxpayer makes a minimum \$10,000 irrevocable gift to one of these funds and receives an immediate charitable donation receipt. The fund can sell any appreciated securities it receives without having to pay American capital gains taxes, unlike what would happen if a donor sold the asset himself, paid the taxes and donated the residual. The fund then reinvests the cash proceeds in mutual funds.

The donor's contribution grows tax-free, and can be used to make gifts during the donor's lifetime or the lifetimes of named successor children and grandchildren. The gift reduces the size of the estate and thus the inheritance taxes owing from the taxpayer's heirs. These funds are organized as investment "pools" and some will pay an income stream to the donor, but that reduces the charitable donation receipt and the income is taxable.

### **How are registered investments donated?**

Registered retirement savings plans (RRSPs), registered retirement income funds (RRIFs), registered annuities and locked-in plans differ from non-registered investments as the source of charitable donations. Their tax-sheltered nature means donors have to pay tax on every dollar taken out of a plan as ordinary income. If the designated beneficiary of the plan is the spouse or common-law partner, the funds may remain as a tax-deferred investment in the spouse's or common-law partner's name. The government will consider there has been a deemed disposition of the registered plan on the date of death and assess a tax liability to the donor's estate.

Donors can name a charity as the plan beneficiary for the RRSP or RRIF. The donation qualifies as a charitable donation and thus allows the estate to receive a charitable donation tax credit. In addition, since the registered plan falls outside of the estate, it is not subject to probate. Note, this does not apply to registered pension plans or other registered plans.

Those clients converting from RRSP to RRIF (usually at age 69) can withdraw a portion and contribute it to a charity. The amount withdrawn is taxable. The withdrawal does reduce the available retirement income, but this is partially mitigated by the donation tax credit and allows the donor to witness the benefits of the gift during their lifetime.

***The information provided is accurate to the best of our knowledge as of the date of publication, but rules and interpretations may change. This information is general in nature, and is intended for educational purposes only. For specific situation you should consult the appropriate legal, accounting or tax expert.***

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