Donating Appreciated Securities.

The benefits of making a charitable donation are countless – from helping those in need to the personal satisfaction we feel when giving something back to a cause we feel passionate about. Charitable giving also makes good sense from a tax perspective. With proper planning, you can reduce your total income tax liability and maximize the value of your donation.

In an effort to increase charitable donations, the tax law allows for the full elimination of any capital gains tax on donations of publicly traded securities to a registered charity[1]. Qualified securities include shares, bonds and mutual funds listed on a prescribed stock exchange.

Charitable Donation Tax Credit

Similar to cash donations, the fair market value of property (i.e., securities) donated to a qualifying charity is reported on a charitable tax receipt, which can reduce an individual donor's taxes through a donation tax credit. The maximum amount of all donations an individual can claim on his/her tax return each year is 75% of net income. Donations that cannot be claimed in a given tax year can be carried forward for up to five years. For donations in excess of $200, the federal tax credit is calculated at the top marginal rate, regardless of the marginal tax rate of the donor[2,3].

Donating securities

If you are planning to make a charitable donation this year, consider this tax-saving strategy; especially if you've already determined that you will be selling some of your current investments to provide the cash to fund this donation. By donating securities directly to a charity, you have an opportunity to reduce the tax you would otherwise have to pay on the sale of your investments. Although a donation of property is considered a disposition for tax purposes, as a result of these tax incentives the taxable capital gain realized on a donated publicly-traded security can be eliminated. Whether you donate cash or the securities directly, you will receive a tax receipt for the full amount of your donation, regardless of the tax treatment of the capital gain.

The table below illustrates how this special incentive increases the impact of a charitable donation, when the property donated is a qualified security instead of the cash proceeds from the sale of a security.

Benefit of Donating Appreciated Securities

Tax on disposition	Sell Security and Donate Cash		Donate Security	
Capital gain on sale of security	$50,000		$50,000	
Taxable portion of capital gain	50%		0%	
Taxable capital gain	$25,000		$0	
Income tax payable (46%)[4]		($11,500)		($0)
Donation Credit				
Charitable donation amount	$50,000		$50,000	
Add tax savings from donation (46%)[5]		$23,000		$23,000
Net Tax savings		$11,500		$23,000
Net cost to donate $50,000		$38,500		$27,000

The example assumes an individual owns a security with a current value of $50,000 and a nil tax cost base. It further assumes that the capital gain realized on the sale is $50,000, and the entire $50,000 proceeds are donated to a charity. In the first situation, the security is sold and the cash proceeds are donated. In the other situation, the security is donated directly to a charity.

As the table shows, a donation of securities may be preferred over a cash donation of equal value, particularly if you have already decided to dispose of the securities during the year.

Estate Donations[6]

To encourage donations by bequest – in the year of death – the maximum donation that can be claimed is 100% of the deceased's net income. Any donations that cannot be claimed in the year of death can be claimed on the deceased's previous year's tax return, also up to 100% of net income in that year.

In addition, the strategy of donating appreciated publicly-traded securities can also be used in the year of death to reduce tax to the deceased and create a significant donation to a charity at a fraction of the cost. In the example presented in the following table, we calculated the net proceeds of an investment that is worth $50,000 and has an unrealized gain of $20,000. Let's look at how making a $25,000 donation from this investment will impact the deceased's tax liability (before 2016) if properly bequested in the deceased's Will[6].

By donating half of the investment, the total tax liability on other income realized in the year of death can be reduced. So much so, that a $50,000 investment provides the deceased's estate with after-tax proceeds of $34,200 and also provides for a $25,000 donation to a charity. In other words, it only costs the deceased's estate an incremental $11,200 ($45,400 – $34,200) to make a donation of $25,000 to a charity.

Tax Benefit of a Donation Upon Death (before 2016)[6]

	No Donation		Donation of half of Investments	
Current value of investments		$50,000		$50,000
Capital gain	$20,000		$20,000	
Taxable portion of capital gain	$10,000		$5,000[7]	
Income tax (46%)[4]		($4,600)		($2,300)
Net cash to deceased's estate		$45,400		$47,700
Donate half of the investments				
Less charitable donation amount				($25,000)
Add potential tax savings (vs. other income) from donation ($25,000 @ 46%)[5]				$11,500
Net cash to deceased's estate				$34,200
Net cash to charity				$25,000

Donations of shares or proceeds acquired through employee stock options

Although the benefit received on the exercise of employee stock options generally represents employment income – and not a capital gain – it is also possible to reduce or eliminate this employment income benefit by donating the shares or proceeds acquired through the exercise of employee stock options.

To be eligible for this incentive, the option shares must be publicly-traded securities and the shares (or proceeds acquired through the options) must be donated to a qualifying charity.

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The stock option benefit must also be eligible for the 50% deduction available on the qualified exercise of certain securities. Assuming these qualifications are met, the reduced income inclusion is available if the shares are donated in the year acquired and within 30 days after the option exercise. In addition, in the case of a "cashless exercise," the reduced income inclusion may also be available if the employee directs their financial professional to immediately dispose of the securities acquired from the employee stock options and deliver the proceeds to a qualifying charity. Note that if the value of the shares decrease in the (maximum) 30-day period before making the donation, or if only some of the shares (or aggregate proceeds) received by exercising the options are donated, the tax deduction will be reduced proportionately.

As the tax rules for employee stock options and the related rules used to determine the charitable donation credits are complex, please consult with your tax advisor to determine the appropriateness and the proper implementation of this strategy based on your situation.

Donating flow-through securities – recent budget changes

A popular strategy post-March 2006 – in light of the elimination of the capital gains tax liability on qualifying donations of publicly-traded securities – was the donation of (publicly-traded) flow-through securities which typically have a low or nil tax cost base.

A flow-through share structure allows a company incurring eligible resource expenses to renounce (or flow-through) the expenses to the investor, who can claim these expenses to offset their taxable income. As a result of the deductions claimed, the investor will generally have a low or nil tax cost base on the underlying securities, which are often exchanged (on a tax-deferred basis) for a publicly-traded security, such as a mutual fund. Once publicly traded, these investments were excellent candidates for a qualifying donation as a means of avoiding the significant capital gains that would otherwise be taxed on the eventual sale.

To the extent that the flow-through investment vehicle maintains its market value at the time of donation equal to its original cost, the combined savings of the resource deductions and charitable donation receipt would significantly reduce the after-tax cost of the donation.

However, note that changes enacted in the tax law originating from the 2011 Federal Budget have limited the tax benefits associated with this strategy, by restricting the exemption from capital gains tax on the donation of flow-through investments to the excess of the (cumulative) capital gains over the original cost of acquiring the flow-through investments. Therefore, this strategy is no longer as attractive – although limited grandfathering may exist for flow-through securities acquired prior to the budget changes. Given the complexity of this new legislation, anyone contemplating a donation strategy involving flow-through investments should consult with their tax advisor to confirm the anticipated tax results. In addition to the concerns regarding these amendments, which may restrict the donation incentives, the renounced expenditures claimed from the flow-through investment may create other tax issues; such as the application of alternative minimum tax which will reduce the current tax benefit of the flow-through deductions.

Corporate charitable giving

Corporate charitable giving can also provide the same tax benefits as individual giving, through:

1. Potential elimination of any capital gains tax on a qualifying gift of publicly-traded securities[8] .
2. A tax deduction equal to the fair market value of the gift.

Continued

A corporation will not receive a tax credit for the gifted qualified securities; instead, it will be entitled to a deduction equal to the value of the gifted property. This will result in a reduction of the tax that would otherwise be payable on income earned by the corporation.

However, similar to individuals, corporations are also restricted on the amount of charitable deductions claimed annually. A corporation can deduct charitable donations, up to a maximum of 75% of its current year net income, with the potential to carry forward any excess for up to five years. For a Canadian-controlled private corporation which donates a qualifying publicly-traded security, the 100% non-taxable capital gain portion will be added to the balance of its Capital Dividend Account (CDA)[8]. This notional account, when positive, may be paid to shareholders on a tax-free basis, which could facilitate the withdrawal of funds from the company to its shareholders.

The table below briefly compares the tax benefits of donating qualifying securities personally, or corporately.

Gift of Qualified Securities[8]

Individual	Corporation
Federal and Provincial personal tax credits on the gift value: • Federal portion is 15% for first $200 and 29% for amounts over $200 • Credits limited to 75% of net income (100% in year of death) • Capital gain on qualifying security has 0% inclusion rate.	• Corporation may expense the gift value (up to 75% of net income) as a charitable deduction. • Capital gain on qualifying security has 0% inclusion rate. Non-taxable portion of the capital gain is added to CDA and a positive balance of CDA may be withdrawn as a tax-free dividend.

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Footnotes:

[1] Or other qualified donees. The 2006 Federal Budget fully eliminated the capital gains tax on qualifying gifts to public charitable foundations or organizations after May 1, 2006 and the 2007 Federal Budget extended this incentive for qualifying gifts to private foundations after March 18, 2007.

[2] For provincial tax purposes, the donation tax credit is generally calculated in the same manner (i.e., the first $200 of donation provides a tax credit at the lowest personal tax rate whereas the tax credit for donations exceeding $200 is provided at the highest personal tax rate, with slight modifications for New Brunswick, Quebec, Alberta, British Columbia and Ontario). In Alberta, the tax credit for donations over $200 exceeds the combined top marginal tax rates to provide additional charitable incentives. Notably, British Columbia, Ontario and Quebec recently introduced additional tax brackets for high income earners; however, the donation tax credit for gifts exceeding $200 remains at the previous top tax rate.

[3] As noted, the Charitable Donations Tax Credit (CDTC) provides an individual with a federal non-refundable tax credit of 15% for the first $200 of annual charitable donations and a credit of 29% for the portion of donations that exceed $200. To further encourage charitable giving, the 2013 Federal Budget introduced a temporary First-time Donor's Super Credit (FTDSC), which supplements the CDTC with an additional 25% federal tax credit for a "first-time" donor of up to $1,000 of donations. This measure is available in respect of donations made on or after the March 21, 2013 Budget Date and may be claimed only once in 2013 or a subsequent taxation year before 2018. Notably, this enhanced tax credit applies only to cash donations, and will not apply to the donations-in-kind described herein.

[4] Based upon an assumed top marginal tax rate.

[5] Assumes individual has made other donations of at least $200 in the year and has sufficient other income to avoid the limit on donation claim to 75% of net income (100% in the year of death), but does not qualify for the FTDSC noted above.

[6] This publication, including the examples herein, reflect the current tax legislation at the time of publication. Specifically, the potential implications of the 2014 Federal Budget proposals concerning estate donations made in the context of a death occurring after 2015 have not been reflected in the context of an "in-kind" donation made by an Estate or bequested in a Will. Briefly stated, a special provision within the current tax legislation allows specific donations made pursuant to a Will to be deemed to have been made by the individual immediately prior to his or her death, even though the actual transfer may occur during the estate administration. This treatment can be beneficial in allowing a donation tax credit to reduce taxes otherwise payable at death in the individual's terminal tax return (or in the year preceding death). Similar provisions apply where an individual designates a qualified donee as a beneficiary under an RRSP, RRIF, TFSA or life insurance policy.

However, donations made by an individual's estate (which are not pursuant to the terms of the Will) do not qualify for this treatment and can currently only be applied against the estate's income tax otherwise payable, which may not be sufficient to allow the full benefit of the donation tax credit to be realized. Accordingly, the 2014 Federal Budget proposes to allow more flexibility in the tax treatment of charitable donations in the context of a death occurring after 2015. Specifically, a donation made by Will (and designated donations) will no longer be deemed to be made immediately before death. Instead, these donations will be deemed to have been made by the estate at the time the specific property is donated to the qualifying donee. Furthermore, in qualifying circumstances, the estate trustees will also have the flexibility to apply the donation tax credit (from a qualifying donation made within 36 months of death) amongst any of:

(i) the taxation year of the estate in which the donation is made;
(ii) an earlier taxation year of the estate; or
(iii) the last two taxation years of the deceased individual within the existing annual donation credit limits.

[7] $20,000 Total Gain less 50% non-taxable due to donation times 50% inclusion rate.

[8] Subject to the 2011 Federal Budget amendments discussed herein regarding a donation involving flow-through securities.

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