BMO NESBITT BURNS

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. 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, recent federal budgets have fully eliminated the 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

As with cash donations, the fair market value of property donated will reduce an individual donor's taxes through a charitable donation tax credit. The maximum donation an individual can claim on his/her tax return each year is 75% of net income. Donations that cannot be claimed in the year can be carried forward for up to five years. For donations in excess of $200 the tax credit is calculated at the top marginal rate regardless of the marginal tax rate of the donor[2].

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 previous year's tax return, also up to 100% of net income in that year.

Donating securities

If you are planning to make a charitable donation this year, consider this tax-saving strategy. If you've already determined that you will be selling some of your current investments, you have an opportunity to reduce the tax you would otherwise have to pay on the sale of your investments if you donate the investments directly to a charity. 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 is eliminated. In either case, you will receive a tax receipt for the full amount of your donation regardless of the tax treatment of the capital gain.

Tax Benefit of Donating Appreciated Securities

	Sell Security and Donate Cash		Donate Security	
Tax on disposition				
Capital gain on sale of security	$50,000		$50,000	
Taxable portion	50%		0%	
Taxable Capital Gain	$25,000		$0	
Income Tax (46%)[3]		($11,500)		($0)
Donation credit				
Charitable donation amount	$50,000	$23,000	$50,000	
Add tax savings from donation (46%)[4]		$11,500		$23,000
Net tax savings				$23,000
Net cost to donate $50,000		**$38,500**		**$27,000**

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The table on the previous page 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. The example assumes an individual owns a security with a current value of $50,000 and a nil 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 column, the security is sold and the cash proceeds are donated. In the other column, the security is donated directly to a charity.

As shown, 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.

This strategy 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 next example (presented in the table below), we calculate 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 if properly bequested in the deceased's will.

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 but also provides for a $25,000 donation to a charity. In other words, it costs the deceased's estate only an incremental $11,200 ($45,400 - $34,200) to make a donation of $25,000 to a charity.

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 benefit by donating the shares or proceeds acquired through the exercise of employee stock options.

As above, 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.

The stock option benefit must also be eligible for the 50% deduction available on the qualified exercise of certain securities. Assuming these

Tax Benefit of a Donation Upon Death

	No Donation		Donation of Half of the Account	
Current value of investments	$45,400	$50,000		$50,000
Capital gain	$20,000		$20,000	
Taxable portion	$10,000		$5,000(3)(5)	
Income Tax (46%)(3)		($4,600)		($2,300)
Net Cash		$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%)(4)				$11,500
Net cash to the deceased's estate				**$34,200**
Net cash to charity				**$25,000**

qualifications are met, the reduced income inclusion is available if the shares are donated in the year acquired 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 broker to immediately dispose of 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 above (maximum) 30-day period before 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 in your situation.

Enhancing the tax benefit by donating flow-through shares

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

A flow-through share structure allows a company incurring eligible resources 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 tax cost base of nil 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 may be 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 could significantly reduce the after-tax cost of the donation.

For an investor in the top tax bracket (assumed to be 46%), the net out-of-pocket cost could be as low as 8% of the investment, once the deduction at 46% and the donation receipt at 46% are reflected, since the taxation of the inherent capital gain on the investment could be avoided on a qualifying donation.

However, it is imperative that an investor contemplating this strategy consult with their tax advisors to confirm the anticipated tax results, particularly since the renounced expenditures claimed may create an obligation to pay alternative minimum tax which reduces the current tax benefit of the deductions.

Furthermore, particularly in situations where a flow-through investment is pre-packaged such that the investment is acquired primarily for the purpose of making a gift after a very short hold period, there is a risk that the strategy may be considered a tax shelter which introduces other tax considerations.

Finally, given that flow-through shares are an inherently risky investment, and often impose minimum holding periods for the investor, there is significant market risk such that the underlying investment may not retain its value thereby reducing the amount of the donation receipt and the overall effectiveness of the strategy. This volatility may also create uncertainty for charities in determining the appropriate valuation for the charitable receipts issued at the time the flow-through securities are gifted.

The BMO Nesbitt Burns Charitable Giving Program

If you are interested in making a charitable donation of qualifying publicly-traded securities, consider the BMO Nesbitt Burns Charitable Giving Program. The BMO Nesbitt Burns Charitable Giving Program is an innovative philanthropic service offered through the BMO Financial Group's alliance with Community Foundations of Canada (CFC). BMO Financial Group formed this alliance with CFC because of their deep understanding of local issues and charitable giving expertise.

By establishing a donor advised fund through the BMO Nesbitt Burns Charitable Giving Program, you can make initial and ongoing contributions to the charities of your choice – or to a specific area of interest – while receiving important tax benefits. This unique, flexible solution provides a simple and efficient way for you and your family to build a lasting legacy for tomorrow – while supporting charitable causes you care about today.

One of the features of the BMO Nesbitt Burns Charitable Giving Program is the ability to establish a lasting legacy of charitable giving. You can personalize your donor advised fund with your name, involve family members in recommending grants and name successors, so that your fund will carry on your charitable goals well into the future.

Contact your BMO Nesbitt Burns Investment Advisor for more information on donating your appreciated securities or the BMO Nesbitt Burns Charitable Giving Program. You should also consult with your tax advisor to confirm any potential tax implications associated with a charitable giving strategy since the relevant tax rules can be complex.

(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) In Alberta, the tax credit for donations over $200 exceeds the combined top marginal tax rates to provide additional charitable incentives.
(3) Based upon an assumed top marginal tax rate.
(4) 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).
(5) $20,000 Total Gain less 50% non taxable due to donation x 50% inclusion rate.

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