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. In December 2015, the federal government released proposed amendments to introduce a new top federal marginal tax rate of 33% on taxable income greater than $200,000 which also included changes for higher income donors. For donations in excess of $200 made after 2015, the federal tax credit will be calculated at the new top 33% marginal rate, but only on the portion of donations made from income that is subject to the new top marginal tax rate. For any donations made in excess of $200 where the individual's taxable income is less than $200,000, a 29% federal tax credit will apply, which was the previous top federal marginal tax rate[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 securities 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 value 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 (50%)[4]		($12,500)		($0)
Donation Credit				
Charitable donation amount	$50,000			
Add tax savings from donation (50%)[5]		$25,000		$25,000
Net Tax savings		$12,500		$25,000
Net cost to donate $50,000		$37,500		$25,000

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[6].

Estate donations

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.

The strategy of donating appreciated publicly-traded securities can also be used upon death to potentially reduce tax to the deceased and create a significant donation to a charity. In the year of death, except for transfers to a surviving spouse or qualifying spousal trust, individuals are deemed to dispose of their capital property at its fair market value immediately before death, thereby triggering any capital gains or losses that have accrued until that time.

For deaths prior to 2016, the tax legislation provided for the possible elimination of the taxable capital gain from the disposition of a qualifying security where the disposition is deemed to occur as a result of the taxpayer's death and the security is donated to a qualifying charity pursuant to a specific bequest made by Will. A special provision within the former tax legislation also deemed the donation of the security to have been made by the individual immediately prior to his or her death even though the actual transfer may have occurred in the individual`s estate during the estate administration process. That previous treatment was beneficial in allowing a donation tax credit to reduce taxes otherwise payable in the individual's final tax return (or in the year preceding death). Similar provisions were applicable where an individual designated a qualified donee as a beneficiary under an RRSP, RRIF, TFSA or life insurance policy.

New rules for estate donations (after 2015)[7]

The previous legislation, which was effective prior to 2016, provided that donations made by an individual's estate (which were not pursuant to the specific terms of a Will) did not qualify for the above treatment and could only be applied against the estate's income tax otherwise payable, which was often not sufficient to allow the full benefit of the donation tax credit to be realized. Accordingly, new legislation was recently introduced to allow increased 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 such as those designating a qualified donee as a beneficiary under an RRSP, RRIF, TFSA, or life insurance policy) will no longer be deemed to be made (immediately before death) by the individual decedent but will instead be considered to be made by his or her estate. Furthermore, these donations will be deemed to have been made by the estate at the time the specific property is donated to the qualifying charity. The value of the gift will therefore be the value at the time of the donation and the estate can carry-forward any unused tax credit for five years from the date of gift. Note it is the time of the transfer of the property to a qualified donee that is the appropriate date for valuing the property and thus the donation value for the purposes of the donation tax credit, as opposed to the date immediately prior to the individual's death as under the previous legislation.

Another significant aspect of the new rules that apply after 2015 provides that if there is a gift of property acquired by the taxpayer's graduated rate estate[8] (GRE) on, or as a consequence of, the taxpayer's death, the estate trustees will also have the additional flexibility to apply the donation tax credit amongst any of the following:

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 aforementioned annual donation credit limits.

Similarly, provided the above criteria are met, the special tax incentives eliminating the capital gains tax on a gift of appreciated securities could also apply to deemed dispositions of property on death where the securities are donated by a GRE.

However, as with any changes, the new rules may bring rise to potential challenges that executors may face during the estate administration process that can eliminate the above benefits. An important requirement to note is that to be eligible for the above flexibility, the gift must be made by a GRE. If not, to the extent that the deceased individual has tax otherwise payable in the year of death (such as capital gains resulting from the deemed disposition of investment assets), the executor would not be able to apply the donation tax credit to offset income in the deceased individual`s final return (or the prior year). Given the donation is made by the estate, the donation tax credit in such a case could only be applied in the estate's taxation year in which the donation is made (or in any of its five subsequent tax years). Should the estate not realize sufficient income in the year the donation is made or in any of its five subsequent taxation years, the benefit of the donation credit may be lost.

With respect to donations of appreciated securities, the change in timing of valuation will cause any fluctuations after death in the value of the securities to impact the tax implications to the estate, and the deceased. In addition, there may be cash flow implications since the tax benefit of the donation of the appreciated securities (and the potential elimination of capital gains tax thereon) may not be realized until after the actual gift by the estate has been made, whereas any tax owing at death will be due at the time of filing the terminal return.

In light of concerns raised by the estate planning community over the 36-month timeframe restriction imposed on GRE's required to achieve the above tax benefits, in January 2016, the federal government released draft legislative proposals to extend this time period to allow the donation to be made up to 60 months after the individual's death, as long as the donation is from the estate that ceased to be the individual's GRE because the 36-month time period has lapsed and all other GRE requirements continue to be met at the time the donation is made. As such, these further amendments effectively allow an additional two years to make a qualified donation; however, the additional flexibility for the donations made after 36 months (but before 60 months) following death is extended only to:

i. The taxation year of the estate in which the donation is made; or
ii. The last two taxation years of the deceased individual.

In light of the above, the strategy of donating appreciated publicly-traded securities by an estate can be used to reduce tax to the deceased (and/or the deceased's estate) and create a significant donation to a charity at a fraction of the cost. In the example presented in the following table, the net proceeds of an investment that is worth $50,000 and has an unrealized gain of $20,000 is calculated. Let's look at how making a charitable bequest of $25,000 from this investment will impact the deceased's tax liability.

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 $35,000 and also provides for a $25,000 donation to a charity. In other words, it only costs the deceased's estate an incremental $10,000 ($45,000 – $35,000) to make a donation of $25,000 to a charity.

Tax Benefit of a Donation Upon Death[9]

	No Donation		Donation of half of investmets	
Current value of investments		$50,000		$50,000
Capital gain	$20,000			
Taxable portion of capital gain	$10,000		$5,000[10]	
Income tax (50%)[4]		($5,000)		($2,500)
Net cash to deceased's estate		$45,000		$47,500
Donate half of the investments				
Less charitable donation amount				($25,000)
Add potential tax savings (vs. other income) from donation ($25,000 @ 50%)[5]				$12,500
Net cash to deceased's estate				$35,000
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 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 exercising 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 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.

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[6].
2. A tax deduction equal to the fair market value of the gift.

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 its Capital Dividend Account (CDA)[6]. 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[6]

Individual	Corporation
Federal and Provincial personal tax credits on the gift value: • Federal portion is 15% for first \$200 and 29% or 33% 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.

Conclusion

In addition to the many benefits of charitable giving, there are considerable tax incentives to donate, especially when gifting appreciated publicly-traded securities. In light of the recent important changes to the tax legislation governing charitable giving – particularly involving estate donations – please be sure to speak with your tax and/or estate advisors for assistance in developing and implementing your charitable giving strategies.

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. On a related note, the 2015 Federal Budget proposed a similar incentive in specific situations after 2016 where cash proceeds following the arm's length disposition of private corporation shares or real estate are donated within 30 days of the sale. Please refer to our 2015 Federal Budget Review for further details regarding this proposal.

2. For provincial tax purposes, the donation tax credit is generally calculated in a similar 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 and Ontario). In Alberta, the tax credit for donations over $200 exceeds the combined top marginal tax rates to provide additional charitable incentives. Notably, 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. However, the Quebec tax credit for donations less than $200 is calculated at the second lowest tax bracket resulting in an added benefit.

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% or 33% 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 is subject to the new top federal tax bracket, 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. Note that changes enacted in the tax law originating from the 2011 Federal Budget have limited the tax benefits associated with a donation involving flow-through securities 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. Please consult with your tax advisor for further details.

7. Note this publication focuses on new tax rules relating to an individual's estate. New tax rules have also been introduced affecting other trusts such as alter ego trusts, joint spousal or common-law partner trusts, and spousal or common-law partner trusts. These new rules affect the incidence of tax on the death of the beneficiary individual as well as the timing and ability to claim donation tax credits within such trusts. Please refer to the publication titled *New tax rules affecting your Estate Plan* for further information.

8. After December 31, 2015, the graduated rate estate of an individual at any time is the estate that arose on and as a consequence of the individual's death, if that time is no more than 36 months after the death and the estate is at that time a testamentary trust. There can only be one graduated rate estate associated with an individual and it must designate itself as such in its T3 return for its first taxation year and include the individual's Social Insurance Number in its return of income each year after 2015.

9. Example assumes the investment security retains same value at death as when donated by the estate and that the estate is a GRE.

10. $20,000 Total Gain less 50% non-taxable due to donation times 50% inclusion rate.

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