

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 charity¹. 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}.

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.

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.

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

Tax 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

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.

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

example presented in the table below, 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 if properly bequeathed 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 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.

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.

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

Tax Benefit of a Donation Upon Death				
	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 ⁶	
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

implementation of this strategy based on your situation.

Donating flow-through shares – 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 shares 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, going

forward this strategy will no longer be as attractive in the future – although limited grandfathering may exist for flow-through securities acquired prior to the budget changes. Given the complexity of this new legislation and the limited interpretative guidance provided thus far, 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 securities⁷.
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 the balance of its Capital Dividend Account (CDA)⁷. 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 ⁷	
Individual	Corporation
Federal and Provincial personal tax credits on the gift value: <ul style="list-style-type: none"> • 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. 	<ul style="list-style-type: none"> • 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.

For more information, speak with your BMO financial professional.

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 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 an additional surtax and tax bracket for high income earners respectively; 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 will supplement the CDTC with an additional 25% federal tax credit for a "first-time" donor of up to \$1,000 of donations. This measure will be 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 \$20,000 Total Gain less 50% non-taxable due to donation times 50% inclusion rate.

⁷ Subject to the 2011 Federal Budget amendments discussed herein regarding a donation involving flow-through securities.

BMO Financial Group provides this publication to clients for informational purposes only. The information herein reflects information available at the date hereof. It is based on sources that we believe to be reliable, but is not guaranteed by us, may be incomplete, or may change without notice. It is intended as advice of a general nature and is not to be construed as specific advice to any particular person nor with respect to any specific risk or insurance product.

Comments included in this publication are not intended to be legal advice or a definitive analysis of tax applicability or trusts and estates law. Such comments are general in nature for illustrative purposes only. Professional advice regarding an individual's particular position should be obtained. You should consult an independent insurance broker or advisor of your own choice for advice on your insurance needs, and seek independent legal and/or tax advice on your personal circumstances.

BMO Nesbitt Burns Inc. and BMO InvestorLine Inc. are wholly owned subsidiaries of Bank of Montreal and Members of the Canadian Investor Protection Fund and IIROC.

® "BMO (M-bar roundel symbol)" is a registered trade-mark of Bank of Montreal, used under licence.