



Portfolio Strategy

Throughout the challenging environment of the pandemic, many companies – across multiple sectors – have been able to adapt well and continue reporting record levels of profitability. How long this can last is a key question as it will have a significant impact on the value of stock markets. Encouraging is that there remains considerable pent up demand for many products, including cars, electronics and technology solutions, which should extend through 2022 and into 2023. Longer term, productivity gains (from technology investments) should help counteract negative impacts of inflation.

In October, equities in both Canada and the US bucked historical seasonality trends and posted impressive returns, gaining about 5% and 4% (in Canadian dollar terms) respectively. Meanwhile, in fixed income, continued pressure from rising interest rates led to declines in both Canadian and US bond markets. Preferred shares posted solid gains, with the S&P/TSX Preferred Share Total Return Index increasing 1.8% for the month.

In our portfolios we made one change in our equity positioning and one trade in our fixed income positions during October. On the equity side we sold Chilean miner SQM and used the proceeds to buy Albemarle Corp., a US based chemical manufacturer who is also the largest provider of lithium for electric vehicle batteries. In fixed income, we saw another one of our preferred shares being called in, which we used the proceeds for to add to our positions in preferred share ETFs.

With these trades our target asset allocation didn't change remaining overweight to equities, underweight fixed income and maintaining a small cash weighting.

Donating Appreciated Securities

The benefits of making a charitable donation are countless – from helping those in need to the personal satisfaction of giving back to the causes that are important to us. 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. Please see the attached article for details on how to take advantage of this strategy.

As always, if you have any questions, please do not hesitate to contact us.

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October 2021

The benefits of making a charitable donation are countless – from helping those in need to the personal satisfaction of giving back to the causes that are important to us. 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, debt obligations or rights listed on a designated stock exchange, and shares/units of mutual funds and exchange-traded funds (“ETFs”).

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 the 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.² Donations that cannot be claimed in a given tax year can be carried forward for up to five years. In 2016, a top Federal marginal tax rate of 33% was introduced on taxable income greater than \$200,000. For donations made after 2015 that exceed \$200, the Federal tax credit is calculated at the top 33% marginal rate, but only on the portion of donations made from income that is subject to this 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.³

Donating securities

If you are planning to make a charitable donation this year, consider this tax saving strategy; especially if you’ve already made the decision to sell 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. As with any sale, a donation of securities is considered a disposition for tax

purposes. However, as a result of these tax incentives, the taxable capital gain that would otherwise be realized on a donated publicly-traded security can be eliminated. Whether you donate the cash proceeds or the security 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 Tax Credit				
Charitable donation amount	\$50,000		\$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 second situation, the security is donated directly to a charity.

As the example 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 their 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 a Registered Retirement Savings Plan ("RRSP"), Registered Retirement Income Fund ("RRIF"), Tax-Free Savings Account ("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 previously noted 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, updated legislation was 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) is no longer deemed to have been made (immediately before death) by the individual decedent, but is instead considered to be made by the individual's estate. Furthermore, these donations are 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; therefore, the donation value for the purposes of the donation tax credit, as opposed to the date immediately prior to the individual's death; as stipulated under the previous legislation.

Another significant aspect of the updated rules that apply after 2015, provides that if there is a gift of property acquired by the taxpayer's graduated rate estate⁸ ("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 within the aforementioned annual donation credit limits:

- 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.

Similarly, provided these 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 updated rules may bring rise to potential challenges for executors during the estate administration process that can eliminate these benefits. Of particular note is that to be eligible for this 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 tax 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 in the value of the securities after death 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 appreciated securities (and the potential elimination of capital gains tax thereon) may not be realized until after the actual gift has been made by the estate, 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 GREs, further amendments to the tax legislation have extended 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. 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.

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. 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.

Tax Benefit of a Donation Upon Death ⁹				
	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 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

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.

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.

However, if an employee donates a publicly-listed share acquired under a stock option that is subject to the new tax rules which preclude the 50% deduction for certain stock options granted after June 2021,¹¹ the employee will not be eligible for a tax exemption on any associated employee stock option benefit. Any capital gain that has accrued since the share was acquired under the stock option agreement will continue to be eligible for the full exemption from capital gains tax, subject to existing rules.

Assuming these qualifications are met (and the new rules restricting the 50% deduction do not apply), 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.

For further information on employee stock options, including important changes recently enacted for stock options granted after June 2021, ask your BMO financial professional for a copy of the publication, *Taxation of Employee Stock Options*. However, 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:

- i. Potential elimination of any capital gains tax on a qualifying gift of publicly-traded securities;⁶ and
- ii. 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 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 following table 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: <ul style="list-style-type: none"> • 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).² • 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. <ul style="list-style-type: none"> • 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.

Consider the tax benefits of charitable giving

In addition to the many benefits of charitable giving, there are considerable tax incentives when donating, especially when gifting appreciated publicly-traded securities. In light of the complexities of 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.

For more information, speak with your BMO financial professional.



¹ Or other qualified donees. The original tax legislation fully eliminated the capital gains tax on qualifying gifts to public charitable foundations or organizations and subsequent legislation extended this incentive for qualifying gifts to private foundations.

² Changes originating from the 2016 Quebec Budget have removed the 75% limitation for 2016 and subsequent taxation years in calculating the qualifying Quebec provincial donation tax credit. Also, note that gifts to foreign charities do not generally result in a charitable donation tax credit for Canadian tax purposes, although many foreign universities will qualify as well as a few specific foreign charities that have previously received a gift from the government of Canada may also qualify. In addition, the Canada-U.S. tax treaty provides some limited tax relief for gifts to U.S. charities. Under specific conditions, a donation claim may be made on U.S. gifts of up to 75% of the net U.S. source income reported on the Canadian tax return. The U.S. source income restriction may not apply under specific circumstances or on gifts made to certain registered U.S. colleges or universities referenced under publicly available listings maintained by CRA.

³ 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 Alberta, Ontario, New Brunswick and Quebec). In Alberta, the tax credit for donations over \$200 exceeds the combined top marginal tax rates to provide additional charitable incentives. Ontario previously introduced an additional tax bracket for high income earners; however, the donation tax credit for gifts exceeding \$200 remains at the previous top tax rate. Similarly, the maximum donation tax credit in New Brunswick is less than the top marginal personal tax rate. Beginning in 2017, the Quebec provincial tax credit for donations greater than \$200 for individuals in the top marginal rate increased to match the top marginal rate. In addition, the Quebec tax credit for donations less than \$200 is calculated at the second lowest tax bracket resulting in an added benefit. Notably, corresponding with the 2020 increase in the top BC provincial marginal tax rate, the BC charitable donation tax credit (for donations over \$200) increased accordingly (for individuals subject to this higher rate).

⁴ Based upon an assumed top marginal tax rate.

⁵ Assumed tax savings, provided that an individual who is subject to the 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).

⁶ Note that the tax benefits associated with a donation involving flow-through securities are limited 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 tax rules for 2016 and subsequent years relating to an individual's estate. Tax rules affecting other trusts such as alter ego trusts, joint spousal or common-law partner trusts and spousal or common-law partner trusts were also recently amended, impacting 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.

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 the 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 multiplied by 50% inclusion rate.

¹¹ Recent changes to the taxation of employee stock options could restrict access to this incentive. Please ask your BMO financial professional for our publication, *Taxation of Employee Stock Options* for further details.

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