

# Wealth Planning

November 2007

## Tax Advantages of Donating to Charity

*"In charity there is no excess." Sir Francis Bacon*

Charities play an important role in society and as a result tax incentives have been created to encourage gifts by individuals and corporations to registered charities. Only donations to charities registered with the Canada Revenue Agency (CRA) offer the opportunity to reduce income taxes therefore it is best to verify whether a charity is registered by searching for it in the CRA Charities Listings ([www.cra.gc.ca/charities](http://www.cra.gc.ca/charities)).

**General Tax Benefits for Individuals.** Donors receive a federal tax credit equal to 15.25% of the first \$200 and 29% on amounts greater than \$200 donated to a registered charity. Unlike an RRSP contribution which lowers your taxable income, a charitable donation creates tax credits that reduces the tax you owe. The charitable tax credit also reduces surtaxes and provincial and territorial taxes. Depending on your individual circumstances, the tax credit will vary based on your taxable income and the province in which you live.

There is a limit to how much you can claim each year and still receive the tax credit. In most circumstances, this limit is 75% of your net income. However, the limit is increased to 100% of net income if the donations or bequests are made in the year an individual dies or the year before the individual's death. Also, for gifts of certified cultural property or ecologically sensitive land, you may be able to claim up to 100% of your net income.

While CRA has set a limit to how much you can claim each year, you do not have to claim all of the donations made this year on your current-year return. You can carry forward any donations you do not claim in the current year and claim them on your return for any of the next five years. Donations must be made by December 31st to be claimed against your income for the current year.

## SPECIAL TYPES OF CHARITABLE GIFTS

**Gifting Publicly Traded Securities.** CRA offers an additional tax incentive to those individuals that wish to donate publicly traded securities such as stocks, bonds and mutual funds to a registered charity rather than the equivalent cash amount. When you donate publicly traded securities in kind, the donation is considered a disposition for Canadian tax purposes. In other words a donation of publicly traded securities to a registered charity results in a capital gain or a capital loss to the donor. However, there is an incentive that eliminates the need to claim a capital gain when securities are donated to a registered charity anytime after May 1, 2006. The following example demonstrates the benefit of donating securities rather than the equivalent cash amount when capital gains are involved.

Example.

	Selling units of a mutual fund and donating cash	Donating units of a mutual fund
Fair Market Value	\$5,000	\$5,000
Less: Adjusted Cost Base	\$3,500	\$3,500
Equals: Capital Gain	\$1,500	\$1,500
Taxable Capital Gain (50% of Capital Gain)	\$750	Nil
Tax on capital gain (assumes 46% marginal tax rate)	\$345	Nil
Charitable Tax Credit (fed + Ont)	\$1,970	\$1,970
Cost of the donation (donation + tax – tax credit)	\$3,375	\$3,030

In this example, an individual that sells units of a mutual fund to raise cash to make a charitable donation pays \$345 more in tax than the person who donates the units of the mutual fund.

**Donating Flow-Through Limited Partnership.** The tax benefit of donating securities is further enhanced when donating units of a mutual fund that was originally purchased as units of a Flow-Through Limited Partnership.

Flow-Through Limited Partnerships own and manage a portfolio of flow-through common shares issued by Canadian mining and energy companies to finance exploration activities. After issuing shares and receiving the capital, these companies pass or flow certain exploration expenses to the investor which results in a tax deduction for the investor. Generally investors receive a meaningful amount of their original investment in the form of tax savings. Once all the tax deductions have been claimed, normally 18 to 20 months, the Flow-Through Limited Partnership is converted into a mutual fund. (for more information on the topic of Flow-Through Limited Partnerships please consult the Dundee Securities Corp Mutual Fund Research Report titled Flow-Through Limited Partnerships 101, January 9, 2007).

If these investments are donated to a registered charity, the investor can reap even further tax benefits. The flow through of expenses noted above reduces the adjusted cost base of the investment significantly. Therefore, if the units were sold the proceeds would trigger a large amount of capital gains tax. However, if units of this particular mutual fund are donated to a registered charity then the tax on the capital gain is zero.

To simplify this example, we have assumed that surtaxes do not apply and that the market value of the flow-through investment neither appreciated nor depreciated during the hold period.

Example Flow-Through LP and Charitable Donation Tax Savings

	Sell flow through/mutual fund and donate cash	Donate units of flow- through mutual funds
Investment in Flow-Through	\$10,000	\$10,000
Tax savings from deductions (46%)	\$4,600	\$4,600
Fair Market Value of Donation	\$10,000	\$10,000
Less: Adjusted Cost Base	\$ -	\$ -
Equals: Capital Gains (Losses)	\$10,000	\$10,000
Taxable Capital Gain (50% of Capital Gain)	\$5,000	Nil
Tax on capital gain (assumes 46% marginal tax rate)	\$2,300	Nil
Charitable Tax Credit (fed + Ont)	\$3,978	\$3,978
Cost of the donation (donation – tax savings from Flow Through + capital gains tax – tax credit)	\$3,722	\$1,422

**Donating shares acquired through Employee Stock Options.** The tax incentive that relates to donating public securities to a registered charity extends to the donation of shares acquired through the exercise of employer granted stock options. When stock options are exercised, a taxable employment benefit is generated equal to the difference between the fair market value of the security on the day of the exercise and the exercise price. In addition to the standard security option tax deduction, the employee can claim an additional deduction if the securities are donated within 30 days from the day the security is acquired, and within the calendar year in which the security is acquired.

	Exercise of stock options, sell shares and donate cash	Exercise of stock option and donate shares in kind
Current value (2,000 options x \$30)	\$60,000	\$60,000
Less: Exercise value (2,000 options x \$20)	\$40,000	\$40,000
Equals: Taxable Benefit:	\$20,000	\$20,000
Security Option Tax Deduction:	\$10,000	\$20,000
Tax payable before Charitable Tax Credit (assumes 46% marginal tax rate)	\$4,600	\$ -

When making charitable donations it's best to consider all your options. Your Dundee financial advisor can assist you with finding the best approach for your circumstances to help make the most effective use of your donation.

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