

## CHARITABLE PLANNING



# DONOR ADVICE

As wealth transfers to the next generation over the next few decades, advisors need to have more philanthropic planning chats with clients. **Frank DiPietro** says donor-advised funds often lead the discussion

**C**anadians are a giving bunch. According to Statistics Canada, 82 per cent of Canadians aged 15 and older made donations to Canadian charities, with total donations and average donation amounts increasing year over year. An interesting, but not surprising trend is that older Canadians tend to give more to charity, with those over the age of 55 representing more than 50 per cent of the total donations. As the population continues to age, and the much discussed trillion dollar transition of wealth to the next generation occurs over the next few decades, wealth advisors will need to incorporate strategic philanthropic discussions with clients. Donor-advised funds (DAFs) are an increasingly popular vehicle in Canada for fulfilling clients' philanthropic objectives. There are a number of ways or strategies clients can make the most of their charitable donations through this vehicle.

A DAF allows Canadians to make an upfront donation to a charitable foundation, thus allowing the donor to obtain the immediate tax savings. However, the funds remain invested within the foundation to grow over the long term, with the donor providing direction as to how to distribute some of the income or capital to the donor's charities of choice on an annual basis. The foundation's role is to assist the donor in maintaining the donated funds and distributing

some or all of the funds to the designated charities on behalf of the donor. In addition, the foundation will also be responsible for all the administrative, operating, legal, and governance of the funds, while the donor remains in full control over how the funds are to be invested and distributed to charity. In essence, a donor-advised fund can provide clients with many of the same benefits as a private foundation, without the need to deal with the administrative burden of creating and maintaining a private foundation.

The DAF is a strategic approach to charitable giving because it allows investors to give today, receive the tax benefits now, but disburse funds to charity over the long term. This long-term approach to giving allows clients the opportunity to create a legacy of philanthropy, make a bigger social impact, as well as allow them to incorporate some of their family values into their financial and wealth succession planning.

## Tax Benefits

While tax benefits are not the primary reason driving Canadians to donate, donations offer clients financial benefits that play an important role in the timing, size, structure, and assets that are used to fund the charitable donation. Clients who donate to charity or to a DAF are entitled to

## CHARITABLE PLANNING

non-refundable federal and provincial tax credits that will reduce their personal income taxes. The federal tax credit is calculated as 15 per cent on the first \$200 donated and 29 per cent on donations in excess of \$200 claimed for the year.

More recently, the federal government has provided additional tax measures that increase the tax savings for clients who donate. Particularly for high-income earners, the federal donation tax credit increases to 33 per cent to the extent that clients have taxable income that exceeds \$200,000 for the year. In addition, a First-Time Donor's Super Credit (FDSC) is a temporary measure that is available until the end of 2017 for clients who are considered a "first-time" donor. The FDSC provides an additional 25 per cent tax credit on a maximum of \$1,000 of cash donations made after March 20, 2013.

The amount of the total tax credit your client receives varies with each province. The general rule of thumb is the tax savings would be approximately equal to your marginal tax rate. However, this too varies by province. The table below provides a summary of the combined federal and provincial tax credits on charitable donations by province compared with the top marginal tax rate by province.

Province	Top Combined (Fed/Prov) Donation Tax Credit Rate (%)	Top Combined (Fed/Prov) Marginal Tax Credit Rate (%)
Alberta	54.00	48.00
British Columbia	47.70	47.70
Manitoba	50.40	50.40
New Brunswick	50.95	53.30
Newfoundland/Labrador	48.30	48.30
Northwest Territories	47.05	47.05
Nova Scotia	54.00	54.00
Nunavut	44.50	44.50
Ontario	50.41	53.53
PEI	51.37	51.37
Quebec	51.56	53.31
Saskatchewan	48.00	48.00
Yukon	45.80	48.00
Federal	29% or 33%	

Source: Canadian Tax Highlights, April 2016, CTF

\*Rates assume donations in excess of \$200; \*FDSC ignored  
\*assumes client claims 33% federal tax credit

One of the decisions your client will need to make is whether they would rather choose to make a gift during their lifetime or donate at death. From a tax planning perspective, the donation tax credit amounts are the same (as described above). The one significant difference is that donations in the year of death can be claimed against 100 per cent of net income in the year of death (and preceding year), whereas lifetime donations are restricted to 75 per cent of net income.

Another decision to discuss with clients is how the donation to the DAF will be funded. In most cases, cash donations are made. However, clients have the flexibility to donate other assets as well, and in some cases it may be preferable to donate non-cash assets to the DAF.

## Donation of Publicly-traded Securities and /or Mutual Fund Investments

Donations of assets other than cash are considered a "gift in-kind." Generally, a gift in-kind results in a deemed disposition, meaning that the asset is considered to be sold at its fair market value on the date of the gift. This rule could give rise to taxable capital gains, although the charitable donation credit will generally offset any tax bill that will arise.

A donation of securities or mutual funds, although considered an in-kind gift, receives special tax treatment. Specifically, the capital gains inclusion rate is reduced to nil for clients who make a direct donation of securities or mutual funds to charity. This means that the capital gains taxes on investments that have appreciated in value can be completely eliminated. This rule applies whether the donation is made during the client's lifetime, or at death via an estate donation. Most DAFs are structured to accept in-kind donations of securities or mutual funds allowing the client to benefit from this important tax rule. Therefore, a client looking to donate to charity and minimize their tax bill would ideally choose to donate in-kind versus liquidating investments and donating the residual cash.

This strategy can also be quite effective for clients who are selling large positions in an investment portfolio and looking for ways to minimize the tax impact. If the client is philanthropic, then the client may consider setting up a DAF and donating a portion of the portfolio to the DAF, perhaps making a large enough in-kind donation to offset the taxable capital gains that is otherwise payable on the remaining portion of the investment the client is planning to keep. Again, this might be a more effective option than liquidating the investments and donating afterwards. Here's an example to illustrate:

Anne lives in B.C. and her effective tax rate is 34.5 per cent. She has a large position in a single stock worth \$750,000. The ACB of the investment is \$270,000. The combined federal / provincial donation tax credit is 43.7 per cent. Her advisor has recommended she sell this position to create a properly diversified portfolio and remove the concentration risk of having a large position in one stock. At the same time, Anne is benevolent and would like to establish a DAF to fund a variety of her favourite charities over the long term. Therefore, the advisor wishes to donate enough of the stock to a DAF in Anne's name to offset the capital gains on the remaining portion of the investment that she will reinvest in a properly diversified portfolio.

Anne donates \$151,000 to a DAF in her name, which qualifies for a donation tax savings approximately equal to \$66,000 ( $\$151,000 \times 43.70$  per cent). Anne donates the stock in-kind and therefore also eliminates the capital gains tax on the portion of the stock that is donated to the DAF. The remaining portion of the portfolio is sold and proceeds used to create a properly diversified balanced portfolio for Anne. The remaining value of the stock is \$599,000 ( $\$750,000 - \$151,000$ ) and the resulting tax liability is approximately equal to \$66,000. The donation tax credit can be used to offset this tax liability.

This strategy allows Anne to achieve the following benefits:

- Eliminate the tax liability on the concentrated portfolio
- Eliminate her concentration risk
- Create a properly diversified portfolio

# CHARITABLE PLANNING

- Fund her philanthropic objective via the DAF in a tax efficient manner

## Gifts of Life Insurance

What about clients who don't wish to give up some of their wealth now or at the time of death, but still have philanthropic objectives and would like to set up a DAF? They could consider the use of life insurance as a means of fulfilling this objective. There are a couple different ways to achieve this, depending again on whether the client wishes to reap the tax benefits during their lifetime, or at death.

First, your client can take out a life insurance policy and designate the DAF as the beneficiary of the policy. Your client retains ownership of the policy, however, when the client passes away, the death benefit is used to fund the DAF and, therefore, the value of the death benefit will provide a donation tax credit that can be used to save taxes in the year of death. In this scenario, no tax savings are available during the client's life.

The second method of using life insurance to make a charitable donation involves transferring the ownership of an existing policy to the DAF and naming the DAF the beneficiary. Under this scenario, a donation credit is available for any cash surrender value that exists at the time the policy is transferred, plus a donation tax credit with respect to any policy premiums the client pays after the transfer. No donation tax credit is available at the time of death with respect to the death benefit paid into the DAF. A caveat here is that a deemed disposition occurs on the transfer of the policy. That is, there may be a tax liability if the cash surrender value exceeds the adjusted cost base of the policy, although the donation credit may likely offset the tax liability. (For more about life insurance and charitable giving, see page 26.)

## RRSP/RRIF Beneficiary Designations

RRSPs and RRIFs may, in some cases, create significant tax liabilities in the year of death. That's because the value of the RRSP / RRIF is included in the final tax return as income in the year of death and taxable at the deceased's marginal tax rate. For example, if a client has a \$250,000 RRIF and passes away, the final tax return may need to report an additional \$250,000 of income that is subject to tax. There are some exceptions however. The tax rules do allow clients to name certain individuals as beneficiaries, such as spouses, partners, minor children, and /or children with disabilities, to defer the tax liability to a future time. To the extent that your client can leave their RRSP or RRIF to one of these individuals is good tax planning.

However, not all clients are in the fortunate position of being able to leave their RRSP or RRIF to such an individual on a tax-deferred basis. For these clients, you may consider their philanthropic objectives as well, and consider possibly naming a charity or DAF as the beneficiary of the RRSP or RRIF. Using the example above, the same client who names a DAF as the beneficiary of the \$250,000 RRIF would still be taxed on this amount in the year of death. However, the value of the donation (\$250,000) is eligible

for the donation tax credit, which would effectively eliminate the taxes payable on the RRSP or RRIF reported into income.

## Testamentary/Estate Donations

An area that has undergone substantial changes starting this year (2016) is testamentary or estate donations. Under previous rules (donations prior to 2016), estate donations were considered to have been made by the individual immediately preceding death. For deaths after 2015, gifts by will or by beneficiary designation will be deemed to be made by the estate. This is a significant change. Under the new rules, there is tremendous flexibility in claiming the donation tax credit, as it may be claimed in the year of death or in the immediately preceding year, or the executor could choose to claim the donation tax credit in the estate.

Key to this flexibility is that the estate qualifies under the tax rules as a "Graduated Rate Estate" (GRE) as it will provide the executor with the ability to use the donation tax credits where they are needed, either in the deceased's final tax return or in the estate. A GRE is the estate that arose on death, is a testamentary trust, and is subject to graduated tax rates for 36 months from the date of death. Certain tax designations also need to be made as well for the estate to qualify as a GRE. Although a GRE technically only exists for a 36 month period, a recent amendment extends the period in which charitable gifts made by an estate would be eligible for flexible allocation to 60 months.

The GRE designation is of significant importance, not only for the flexibility in allocating the tax credits, but also if your client wishes to pursue other strategies, such as making a gift in-kind of securities / mutual funds at the time of death. The previously discussed elimination of the capital gains inclusion on a donation of securities or mutual funds is also available for estates as well, but only if the estate is a GRE for tax purposes. As a result, you may wish to coordinate your client's donation strategy with a qualified tax professional to ensure the estate meets the GRE requirements. Otherwise, the capital gains tax liability may be payable on the deemed disposition of securities.

Finally, under the new rules for estate donations, gifts made by will, designated gifts, and gifts made by an estate will be deemed to have been made at the time the property is actually transferred to a charity. Therefore, the tax receipts issued for gifts in-kind will be for the fair market value of the property at that time of the gift. This is in contrast to the old rules, where the gift was deemed to be made immediately before death and the amount of the receipt was the fair market value of the property at the time of death. The new rules provide much more clarity and simplify the valuation of donation receipts.

DAFs provide a simplified giving mechanism for your philanthropic clients by leveraging the benefits of a private foundation, without the associated costs. Donors can use a multitude of different assets to fund their plan and manage their own legacies over very long time frames. As always, there are a number of tax and estate implications that need to be reviewed and carefully planned for if the client is going to make the most of their charitable donations, and achieve their intended objectives. 

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