The ScotiaMcLeod Wealth Planning Series

Planned Giving Handbook

ScotiaMcLeod™

Building Relationships for Life

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Planned Giving Handbook

As a part of an overall estate plan, planned giving (charitable gifting) can be of benefit to many individuals. In addition to the important humanitarian aspect of this type of planning, the advantages from a tax consideration have grown. While the personal reasons for planned giving are uniquely individual, and therefore will not be considered in this guide, there are ways in which this type of planning can be very advantageous to you and the charity of your choice.

This handbook will focus on several tax effective considerations, however you should consult with your own accountant, lawyer and ScotiaMcLeod Investment Executive when developing your plan.

What is Planned Giving?

In the past, planned giving was commonly called "charitable gifting". Many individuals make gifts or bequests to one or more charitable organizations from time to time yet are not always sure they are doing this in the most effective manner possible. Others wish to be able to create a larger benefit to the charity by way of creating a foundation, however, may be convinced that they cannot afford to do so.

Planned giving simply allows for consideration of how to organize these gifts or bequests in a way that maximizes benefits for everyone. Through the use of planning tools such as wills, trusts and insurance, in addition to an understanding of the tax treatment of bequests, it is possible to create larger benefits to a charity and to generate greater tax advantages for you.

The Tax Rules

You can claim tax credits for gifts made to a charity of up to 75% of your net income in a given year. If your gift should exceed this limit, the excess can be carried forward for up to 5 years. If you make

a gift in the year of your death, usually by will, the limit is 100% of your net income in the year of death with a one year carryback of up to 100%.

A federal tax credit of 17% is available for gifts of $200 or less, and this credit increases to 29% of the excess over $200. When you add the provincial and surtax effects to the federal tax credit, the end result is an overall tax savings of approximately 50% (please note that this will vary by province).

For example, a gift of $10,000 would create a tax credit of approximately $5,000 ($10,000 x 50%).

Since Canada Customs and Revenue Agency (formerly known as Revenue Canada) allows either spouse to claim donations, it is not relevant which individual makes the claim. All claims should be made by just one (the higher income) spouse to avoid having two $200 thresholds in a year. It may also be wise planning to accumulate donations for several years to take advantage of the higher tax credit.

Categories of Charities

In order for your contribution to qualify for a tax credit, it must be made to a "qualified charity." There are two main types of charities. The first type is charitable organizations, which are actively involved in direct charitable activities. These include churches, synagogues and mosques, hospitals, universities, and similar organizations and represent about 90% of the charities registered with Canada Customs and Revenue Agency. The second type is charitable foundations. While a foundation can undertake a direct charitable activity, in most cases its role is to build an endowment (capital) and distribute the income. This income is normally distributed to other charities and these foundations can be public or private.

To determine if a particular charity qualifies for a tax credit, conduct a search through Canada Customs and Revenue Agency's list at: www.ccra-adrc.gc.ca/tax/charities/menu-e.html

Planned Giving Alternatives

There are many methods of planned giving. Following are some methods you may want to consider when developing your plan:

- Gifts Using a Will
- Charitable Remainder Trusts
- Gifts of Marketable Securities
- Gifts of Debt
- Gifts of Capital Property
- Gifts of Real Estate
- Ecological Gifts
- Gifts of Canadian Cultural Property
- Charitable Annuities
- Life Insurance

Gifts Using a Will

There are several types of bequests that can be added to your will. The most common of these is a specific bequest. This would be the outright gift of money, a particular property or source of income. You can also leave a certain percentage of your estate, or bequest the balance of your estate ("residual") to a charity after the distribution of your assets to other beneficiaries has taken place. If you make a "contingent" bequest it will take effect dependent on another event. An example would be a bequest to a charity only in the event that one of your beneficiaries predeceases you.

You can also set up a trust (testamentary) using your will. This trust could allow for the use of particular assets during the life of an individual (usually your spouse) and following that individual's death, the assets would then be left to a charity.

If this type of trust is used for others besides your spouse, there will be a deemed disposition of the assets going into the trust and taxes will have to be paid. As a result, when using a trust for an individual other than your spouse, you may want to consider gifting cash to the trust to avoid these tax consequences.

Charitable Remainder Trusts

If you own capital property with a significant unrealized gain, you can arrange for a specific charity to receive the value of those assets now. It is possible to do this and continue to receive the income from the asset each year. This type of trust can be created by will (testamentary) or during your lifetime (inter-vivos). You should remember that by participating in a charitable remainder trust you will be donating assets that you cannot recover. However, the resulting benefits could be considerable for you and the trust.

To successfully establish this type of trust you must donate the property to the trust irrevocably. As the donor you would be entitled to receive all, or a portion of, the income from the property for life. With this type of planning you may also designate others as income beneficiaries. As an example, you could continue to receive the income for as long as you or your spouse live. The property ("residual interest") will be paid to the charity upon the death of the income beneficiary.

When you transfer the property to the trust there will be a disposition for tax purposes and a realized capital gain if the current value exceeds your original cost base (if depreciation has been taken there will also be recapture of depreciation). However, in order to eliminate this capital gain, you can use a subsection of the income tax act to have an amount between the fair market value and the adjusted cost base treated as the proceeds of distribution. Effectively, by selecting the adjusted cost base, any immediate capital gain tax consequences can be deferred. You should note that the amount you choose will be the value used to calculate the charitable contribution tax receipt.

An additional advantage of establishing this type of trust is the assets gifted will no longer form part of your estate and their value will not be included in the calculation of probate fees.

You own assets with substantial accrued, but unrealized, capital gains and you want to convert these assets to fixed income securities to provide a stable income stream. At the same time, you desire to gift these assets to charity. By gifting the assets to the trust at your cost base you can avoid the capital gains tax. The charity can then sell the assets (the capital gain is allocated to the charity and no tax is payable) and purchase fixed income securities with the proceeds. The income from these securities can then be distributed to you.

If you wish to guarantee the value of the original property to other beneficiaries (spouse, children or grandchildren) you could consider the purchase of life insurance for the value of the original property and name these individuals as beneficiary.

Gifts of Marketable Securities

The 1997 Federal Budget introduced a provision to encourage the gifting of marketable securities to charitable organizations. These securities must be publicly traded and can include segregated funds and mutual funds. Stock originating from employee stock options is also valid, as long as the stock is gifted within 30 days of the option being exercised (and within the same taxation year).

The provision reduced the capital gains inclusion rate for these gifts by one-half. The 2000 Federal Budget changed the inclusion rate on capital gains to 66 ⅔% (from 75%) and as a result the new inclusion rate for gifts of securities is 33 ⅓%. You should note that this reduced inclusion rate was introduced on a trial basis only and is not guaranteed to be continued after the end of 2001. It will allow you to reduce the impact of capital gains taxes on shares donated directly to a charity.

Example:

Mr. Smith is deciding whether to donate $100,000 of XYZ stock to his favorite charity or to sell the stock and donate the cash. The cost of these shares was $50,000.

	Donate stock	Sell stock & Donate cash
Proceeds of Sale	$100,000	$100,000
Cost Base	(50,000)	(50,000)
Capital Gain (A)	$50,000	$50,000
Taxable Capital Gain (B)	16,667 (33.3% of A)	33,335 (66.67% of A)
Taxes Payable on Gain (50% of B) Equals (C)	$8,333	$16,667
Tax Receipt (D)	$100,000	$100,000
*Tax credit (50% of D) Equals (E)	$50,000	$50,000
Less Tax Paid (C)	(8,333)	(16,667)
Net Tax Savings (E - C)	$41,667	$33,333

*This credit is approximate and will vary from province to province. In all cases, individuals may only claim the credit for up to 75% of net income in any given year.

If you are currently buying and selling stock and incurring capital gains and you are also making donations to charities, consider donating the stock that has an accrued gain in place of cash. From the above example you can see that this strategy will reduce the tax you will pay on these gains.

Gifts of Debt

This strategy may be appropriate if you are a shareholder in a Canadian Controlled Private Corporation (CCPC). It is not unusual for a CCPC to "bonus down" to $200,000 of "active business income" in order to qualify for the preferred tax rate available to them. In many cases, the recipients of such payments, usually members of senior management, loan back to the corporation the after tax bonus. As a result the corporation may have large "due to shareholder" amounts with no intention of loan repayment.

If you are an owner/manager and you wish to gift these due to shareholder amounts to a charity, you must first convert this debt to shares. Subsequent to conversion, and assuming all requirements for expected gifts have been satisfied, it is then possible for you to donate these shares as noted above in the section entitled Gifts of Marketable Securities.

Gifts of Capital Property

Capital property includes any depreciable property and any property, which when disposed of, would result in a capital gain. You can gift capital property to a charity without using a trust. There are two components to gifting capital property:

- The value of the property must be determined for the purposes of issuing a charitable receipt.
- There will be deemed disposition of the property equal to its fair market value. This disposition will have no effect if the fair market value is equal to the cost base, however, if it is greater, then 66 ⅔% of the capital gain will be included in your income.

You can eliminate the capital gain by using the same subsection of the Income Tax Act as described in the section on Charitable Remainder Trusts. Because each situation is different, and can be complex, it would be advisable to consult your accountant if you are considering this strategy.

Gifts of Real Estate

With a gift of real estate, there are two tax consequences. First is the tax payable on the capital gain. The other tax consequence occurs if the real estate has been depreciated over its life. If this has been done, there will be a “recapture of depreciation.” While only 66 $^{2}/_{3}$% of the capital gain will be brought into income and taxed, 100% of recapture will be taxed. An election in the Income Tax Act can be used to reduce the proceeds of distribution for a gift of capital property, however, is not available to reduce recapture.

Ecological Gifts

In recent years, the government has been encouraging the gifting of ecologically sensitive land (i.e. land important to the preservation of Canada’s environmental heritage). A credit of up to 100% of your net income can be claimed on gifts of these types of property to Canadian municipalities and certain registered charities.

Gifts of Canadian Cultural Property

A credit of up to 100% of your net income can also be claimed for gifts of Canadian Cultural Property (i.e. national treasures). The fair market value of these gifts must be determined by the Canadian Cultural Property Export Review Board. The capital gains arising on the deemed disposition of this type of property are not taxable.

Charitable Annuities

If you wish to leave a sum of money to a charity, and you or your spouse would still like to receive an income from this money for life or for a specific period of time, then you may want to consider charitable annuities. This plan can be particularly attractive to people in their seventies or eighties. The premise of this method is to “invest” (irrevocably) a sum of money in the charity.

Based on this investment, the charity will pay you an annual guaranteed set rate of income for life (or for a number of years). The charity has the option of determining the income they can pay you from this money. In most cases, they will purchase an annuity from an insurance company, which will guarantee this income. The annuity payments received are usually smaller than if you had purchased directly from the insurance company. However, if structured properly, all or a substantial portion of the income you receive will be tax-free. This tax-free income will not impact upon the clawback provisions on OAS and other income tests for government benefits.

An additional advantage to this strategy is that, in some cases, you may also receive a receipt for a charitable contribution, which will result in current tax savings. Because this method of gifting can be more complex than others, you should seek the advice of your accountant and an opinion from the beneficial charity as to the appropriateness of this plan.

Note: CCRA has stated that (for tax purposes) charitable organizations may generally enter into these arrangements to issue annuities, however, charitable foundations may not.

Life Insurance

You do not have to be a millionaire to leave a million dollars. For personal reasons you may wish to create a substantial bequest or a foundation for a particular charity or group of charities. There are three ways that life insurance can be of value:

1) You can apply for a new life insurance policy and name the charity as beneficiary. The premiums you pay will be recognized as a charitable donation and a tax receipt will be issued to you each year.

   Note: Be sure to purchase the insurance policy without paying any money until the policy is approved. Once approved you can transfer the ownership to the charity and then pay the premium.

2) You can donate an existing insurance policy to the charity. A tax receipt will be issued by the charity for the cash surrender value (minus any outstanding loans) plus any accumulated dividends or interest. If this is done, the policy is treated as if it were disposed of and any "policy gain" would be taxed as income to you. As before, all future premiums paid are considered a charitable donation.

The premiums paid in both cases outlined above are treated as a donation whether you pay the premiums directly to the life insurance company or to the charity with instructions that they pay the premiums with the money. Both these methods will result in the tax deduction occurring during the life of the donor.

3) You can purchase an insurance policy and name your estate as the beneficiary, or name your estate as the beneficiary of a policy you now own. You can then add a clause to your will to donate these proceeds to one or more charities. There will be no current tax advantage, however, your estate will receive the charitable donation tax credit when the proceeds are distributed to the charity. The tax credit in your terminal tax return will offset additional taxes your estate may incur as a result of capital gains being realized at your death.

Currently you cannot qualify for the charitable donation tax credit if you designate a charity as beneficiary under an insurance policy without having the charity own the policy. There is a proposal in the 2000 federal budget, which would allow you to designate a charity as a beneficiary in a life insurance policy (or RRSP or RRIF), and this designation will qualify for the tax credit. This change will apply in respect of an individual's death that occurs after 1998. Effectively this would now allow the proceeds of the insurance policy to be paid directly to the charity. Under this proposal, these proceeds would therefore not be subject to probate fees.

Developing Your Strategy

The examples in this publication show how proper planning can result in significant savings for you and in a greater gift to the charities of your choice. You should remember that tax considerations are only one part of developing your donation strategy. With the use of professional advice, and any combination of a variety of the innovative and creative methods outlined above, you can have the flexibility to develop a plan that meets all of your objectives.

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