Charitable Giving

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Making the Most Efficient Donation

Whether you are new to charitable giving or a seasoned philanthropist, it is always worthy to ensure that you are gifting your money in the most efficient way. Seeking the advice of a qualified portfolio manager will ensure that you are following this (and any other Qub[Ed]) technique properly.

Not "efficient" in the traditional sense: this article is not analyzing the operations of the largest not-for-profits (NFPs) or offering the quickest way to get a charitable tax receipt.

Instead, we want to shed light on a technique that individuals or corporations can use to maximize the charitable tax credit and get more money into the charity's hands, resulting in a win-win situation for the gifter and giftee.

In order to explain how it works, let us make sure we understand the basics; the tax treatments of charitable donations.

Basic Charitable Donations

In order for a donation to be eligible for the Charitable Tax Credit (CTC), the organization receiving the gift must be a registered charity (have a business number). You must also receive an official charitable donation tax receipt following the transaction. If these conditions are not met, you still did a very good thing, but you will not get the tax deduction.

If you are unsure whether your organization of choice is registered, you can search for it here.

Donations do not need to be liquid cash. The CRA defines donations as a gift for which no consideration is given in return. In other words, there are no strings attached. Your donation can be anything with a fair market value such as property, investment securities, or cultural property.

Providing a professional service for free to a registered charity does not qualify as an eligible gift. However, if a charity gives payment for a professional service, which is then regifted back to the charity, the amount will qualify for the tax credit.

Federal Tax Credit

In order to sweeten the pot and incentivize charitable donations, the government has created a very generous charitable tax program. On the federal level, the credit system is as such:

First $200 of donation value= 15% tax credit
On the amounts above $200= 29% tax credit*

*If you have income that is taxed at the 33% tax rate (income over $221,708 as of 2022), then you can receive a 33% credit on an amount of the donation that is equal to the income that is taxed at that higher rate.

For example, if you had income of $250,000 this year, then $28,292 is taxed at 33% ($250,000-$221,708). If you made a charitable donation of $40,000 in the same year, your charitable tax credit (in this example, only the federal portion) will be:

First $200= 15% credit = $30
The portion in 33% bracket = $28,292 x 33% = $9,336
The rest= $40,000- $200 - $28,292 = 11,508 x 29%= $3,337
Federal CTC to reduce your taxes payable= $12,703

If you do not have income that is taxed at the 33% bracket (i.e., you have income less than $221,708 in 2022), then your tax credit would be 15% of the first $200, and 29% of the rest.

Provincial Tax Credit

In order to keep things simple, we will only refer to Alberta tax rates for this example. If you are situated in another province, calculate your expected credit using this calculator.

Although Alberta's highest personal income tax rate is 15%, it provides a charitable tax credit of 21% of donations over $200. For donations under $200, the tax credit is 10%.

Adding to the above example, your provincial CTC would be:

First $200= 10%= $20
Any amount above $200= $40,000-$200= $39,800 x 21% = $8,358
Provincial CTC to reduce your taxes payable = $8,378
Combined Federal & Provincial CTC= $21,081

As you can see, the higher the donation, the higher the tax reduction. In this example, the tax incentive resulted in nearly 53% back in non-refundable tax credits.

A **non-refundable tax credit** essentially means that if the tax credit was larger than your taxes owing, you would not receive a cash refund for the overage. However, if your CTC is larger than your taxes owing, you are able to carry the excess amount forward for five years to reduce future taxes. Non-refundable tax credits are in direct contrast to refundable tax credits; the most popular kind being the RRSP refund.

Here is where some of the real planning comes in. If you find relevancies or planning points that are similar to your situation, consult with one of our portfolio managers for more customized planning. There is more where this comes from.

Donating Investment Securities In Kind

When You Donate Personally

In the previous example, you donated $40,000 in cash. Let us assume that prior to the donation, you liquidated some investments in your savings account to convert to cash for the donation. Unless you withdrew these holdings from your TFSA, you will have a tax bill from the appreciated securities because you will have a capital gain on the amount of growth the stocks had before you sold.

If the stocks grew 30%, you would have had to sell $42,345 worth of your savings to donate $40,000 after-tax (50% of the gain would be taxable). The transaction would look like this:

Initial Savings: $32,573
Investment Growth, 30% = $9,772
Account Value at Donation= $42,345
Capital Gains Tax, 50%= $4,886 x 48% tax rate* = $2,345
After Tax Donation Value= $40,000
Combined CTC= $21,081

The $2,345 that you will need to pay in capital gains tax will be completely offset by the CTC. However, looking at this from a larger lens, it is not the most efficient.

The tax you need to pay will be refunded anyways. If there was no tax applied, you could have just donated the full account value of $42,345 and received a CTC in relation!

We are able to skip the tax altogether by donating the appreciated securities in kind. By donating in kind, the charity receives the before-tax amount, and you will receive the CTC on the before-tax amount as well.

An **in-kind donation** is a gift of stocks, bonds, or other securities instead of cash. Most charitable organizations hold investment accounts for this exact purpose and sell the securities when they receive them because they are tax-exempt organizations.

The transaction will look like this:

Initial Savings: $32,573
Investment Growth, 30% = $9,772
Account Value at Donation= $42,345
Capital Gains Tax= 0
After Tax Donation Value= $42,345
Combined CTC= $22,234

By transferring in kind, the charity received $2,345 more in donation value, and you received $1,153 more in a tax credit than if you were to sell the securities first and donate the cash.

When You Donate From Your Corporation

Although corporations do not receive a CTC after they make a donation, they are able to expense the donations to reduce their taxable income. A corporation's donations do not need to be expensed in the year that they were made; they can be carried forward five years to be applied against future years' income. A corporation is able to expense donations up to 75% of its net income in any given year.

Now, recall in the first example how you were able to avoid the capital gains tax on the donation of the securities. For corporations, we are able to extend this benefit further with the use of the Capital Dividend Account (CDA).

The CDA is a notional account used to record and keep track of the portion of the capital gain that is not subject to tax. (Recall that only 50% of a capital gain is taxed.) Shareholders are able to withdraw tax-free dividends from their corporation by using the CDA credits they have generated.

A **notional account** is for recordkeeping purposes only. The value of the account is not as an actual account with the funds reserved in it; it is just a record. Your RRSP contribution room—which is kept track of by the CRA—is a notional account, for example.

Reframe our first example, where you sold investment securities to have $40,000 in after-tax cash. This time, assume that this investment account was actually held by a corporation you own.

When you sold $42,345 worth of securities, you had a capital gain of $9,772. Fifty percent of that gain would be taxable, and the other 50% would not. The CDA would be credited $4,886 to reflect the portion that is tax-free, and shareholders can claim these credits at any time.

Since you want the funds taken out of the corporation to donate, you would use these CDA credits immediately. However, the point of the CDA is to allow shareholders the ability to choose when to take out these non-taxable dividends. (It does not have to be the year they were created.)

The Real Bonus

If you recall, when you personally donated securities in kind, you skip the taxation step, thereby receiving a CTC on the appreciated amount and gifting more to the charity. This same type of benefit can be applied to corporations as well, but instead of the CTC, they use the Capital Dividend Account.

When you donate the securities in kind to a registered charity, it effectively makes 100% of the value of the securities tax-free, instead of 50%.

By donating securities in kind from your corporation, 100% of the value gets credited to the CDA, allowing you to withdraw the full amount of the capital gain as tax-free dividends whenever you want. Thinking back to the previous example, instead of $4,886 being credited to the CDA, the full gain of $9,772 gets credited.

The 100% credit to the CDA, along with the increased deduction to taxable income proves that in-kind charitable donation transfers are very efficient ways to help your community with your corporation.

In Conclusion...

If you are considering this strategy of charitable giving either from your corporation or personally, it is important to make sure that your charity of choice is able to receive such donations. As well, for corporate owners specifically, having your portfolio manager work in tandem with your accountant will allow for the customization and optimization of this technique.

Alternatively, you can use organizations such as CanadaHelps to process these transfers, regardless if your charity of choice has an investment account. CanadaHelps, a registered charity itself, acts as the intermediary between you and your charity. Your donation will technically be to CanadaHelps, but you will be providing specific direction about what charity to which CanadaHelps will send the cash once it has been liquidated. It is important to note that, due to operational costs and trading fees, your donation will be subject to a fee prior to being sent to your charity. For in-kind donations, this fee will range from 2.0%-3.0%.

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