Five Reasons You Should Open a DAF Account

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The Advantages of Donor-Advised Funds

There is no question that philanthropy is part of Canadian culture, with one in five Canadians claiming charitable donation credits on their tax returns. At the same time, recent reports indicate that there is a drift toward older donors, with the median age inching up each year. For example, in 2020, 32% of Canadian tax filers over 65 reported charitable donations, while only 11% of those aged 25-34 reported donations.

This is of increasing concern as the charitable sector in Canada is significant. As of 2022, Canada had over 73,000 registered charities with activities in social welfare, health and education, and religious and environmental sectors, to name just a few. Canada also reported just under 5,000 public foundations and 6,000 private foundations. Also, in 2022, $123 billion was held within these foundations, with over $8B granted to charities.

Here we will highlight the benefits of DAF accounts as well as discuss how they can be used to gain a number of advantages including the inspiration of charitable activities in younger people.

Defining a DAF

A donor-advised fund account, or a DAF account, is like having a charitable investment account. Funds placed into the account qualify for charitable donation receipts, with the cash ultimately going to registered charities in the years to come. DAF accounts are held within charitable foundations (including the Qube Charitable Foundation) often in the donor's name. In short, they are like having your own foundation but without the administrative challenges.

DAF accounts often exist because of cash flow and/or tax timing imbalances. Many Canadians, for many reasons, have moments when cash becomes available and donation tax credits are needed. As charitable donation receipts are issued on a cash basis, these taxpayers will want to claim the donation today for tax purposes, but potentially take time to determine to which charities the funds will be granted.

For example, one may have sold a business triggering taxable inclusions, which is a classic scenario that could utilize the creation of a DAF account. Similarly, selling an appreciated asset (like a recreational property) could benefit from a DAF. Further, a period of time where high income is enjoyed, like the final years of a successful career, can cause a DAF account to be considered.

Naturally, there are also non-tax motivators for DAF accounts, like moments when cash is plentiful and one desires to normalize the donations (spread them out). Lottery winnings, inheritances, and downsizing of the principal residence are great examples.

6 Scenarios

where you might want to open a DAF account

We at Qube believe that there are five big reasons to consider a DAF account:

1. Capture Major Tax Savings

A charitable donation will attract significant tax credits in Canada and with some creative planning, these credits can be maximized. For example, a corporate donation of appreciated securities (e.g., stocks) could attract tax credits equal to 70% or more of the donation. Meaning the donation effectively costs the donor less than thirty cents for each dollar the charity receives—more details on this to come.

One can donate far more than cash, including securities (stocks), real estate, life insurance, and private company-preferred shares. These donations can kick-start a quality DAF account and philanthropic program.

2. Gain Expertise to Assist Your Plans

As our first reason highlights, there is much to gain from professional advice, but these gains can extend beyond taxation. DAF accounts, hosted by quality service providers, can assist in finding qualified donees that match the values of the donor. Further, creative assistance can be gained to potentially fund charitable activities directly.

3. Grow Your Future Charitable Funds

Like a bank account for your charitable giving, DAF accounts can warehouse resources until they are sufficient to fulfill their stated purpose. For example, the donor may wish to assist a charity with a capital improvement (e.g., a commercial kitchen for a church) and will use the DAF account to build those funds over several years.

4. Teach Philanthropy

While DAF accounts can exist perpetually, using the documents drafted by the original donee, some will offer opportunities for subsequent generations to guide the philanthropy. For example, grandparents could fund DAF accounts while allowing grandchildren to decide which charities to grant the cash to, guided using stated values defined and followed by the DAF. This can be a powerful tool to orient younger demographics to the charitable community, hopefully inspiring them and reversing the recent trends seen in donor profiles.

Qube is always thinking about the long term. That's why we want to make your wealth matter, not only for you, but for your beneficiaries as well! Positive financial stewardship is an integral part of our Intergenerational Planning, a service included in our investment fees.

5. Donate Anonymously

Finally, a DAF account may allow your donations or grants to remain anonymous to not just the general public but also the recipient charity, should you wish for it. Philanthropy can be complex, and, for various reasons, we have seen an increase in anonymous donations in recent years.

DAF Accounts & Tax Savings

Whether you are new to charitable giving or a seasoned philanthropist, it is worth ensuring that you are gifting your money most efficiently. Tax credits are outlined in our prior Charitable Giving Qub[Ed] article, but here is a refresher.

Basic Charitable Donations - For a donation to be eligible for the Charitable Tax Credit (CTC), the organization receiving the gift must be a registered charity (have a BN number).

You must also receive an official charitable donation tax receipt following the transaction. If you are unsure whether an organization is registered, the Government of Canada has made it easy to check online.

Federal Tax Credit - In order to incentivize charitable donations, the federal government has created a generous charitable tax credit. On the federal level, the credit is:

First $200 of donation value= 15% tax credit
On the amounts above $200= 29% tax credit
For those with taxable income over $221,708 (2022), a 33% federal credit on donations within that bracket.

Provincial Tax Credit - 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%. Therefore, it is possible in Alberta to pay a 48% marginal income tax rate (combined federal and provincial), while receiving nearly 53% in non-refundable tax credits. If your tax credit exceeds taxes owing, you can carry the excess forward for up to five years, reducing future taxes. Alberta is also implementing a super credit on the first $200, allowing total tax credits to hit 75% on that initial donation.

Personal In-Kind Donations - Recent additional tax incentives were created targeting in-kind donations, or direct donation of assets other than cash. Should these assets have appreciated in value and be subject to tax on their disposal, these new incentives exempt the taxation, making these donations incredibly more valuable than cash donations.

For example, we can compare the donation of stocks that were originally purchased for $40,000, but increased in value 30% ($52,000). In one strategy, one could sell the investments and donate the cash proceeds. Cash proceeds, of course, would be after capital gains tax was paid on the investment gain. The transaction would look as follows:

Initial Savings: $40,000
Investment Growth, 30% = $12,000
Account Value at Donation= $52,000
Capital Gains Tax, 50%= $12,000 x 48% tax rate = $5,860

Alternatively, one could donate the securities directly to a DAF account or charity and receive a donation credit on the full market value. The transaction will look as follows:

Initial Savings: $40,000
Investment Growth, 30% = $12,000
Account Value at Donation= $52,000
Cash Proceeds/Donation = $52,000

By transferring in kind, the charity received $5,860 in additional resources while the donor received a significantly larger donation tax credit.

Corporate In-Kind Donations - Although corporations do not receive a donation tax credit when making donations, they are able to expense the donations, achieving nearly synonymous results. Further, a corporation can also carry a deduction forward five years to be applied against future years' income and expense donations up to 75% of its net income in any given year (similar to personal donation rules).

Like personal donations of in-kind assets, corporations are also exempt from the capital gains tax on the disposition. Uniquely advantageous to corporations, they continue to receive on the disposition a Capital Dividend Account (CDA) credit. Every corporation has a Capital Dividend Account. It does not appear on a corporation's balance sheet, but it's detailed in the notes to its financial statements. It is a notional account used to keep track of realized capital gains not subject to taxation.

By claiming the CDA credit, shareholders can withdraw the non-taxable portion of the capital gain on a tax-free basis, thereby escaping dividend taxes. If we crystallize unrealized capital gains through the typical sale of a security, only 50% of the capital gain is taxable; hence only 50% of the capital gain is credited to the CDA. But, in the case of an in-kind donation of appreciated securities, 100% of the realized capital gain is non-taxable. Therefore, 100% of the gain will be credited to the CDA. This peculiarity of the tax code can be very powerful!

In-Kind Donation in Practice

Let's review how a donation of $1,000 from a corporation or shareholder could save $732.88 in taxes if done optimally, i.e., through an in-kind donation of appreciated securities.

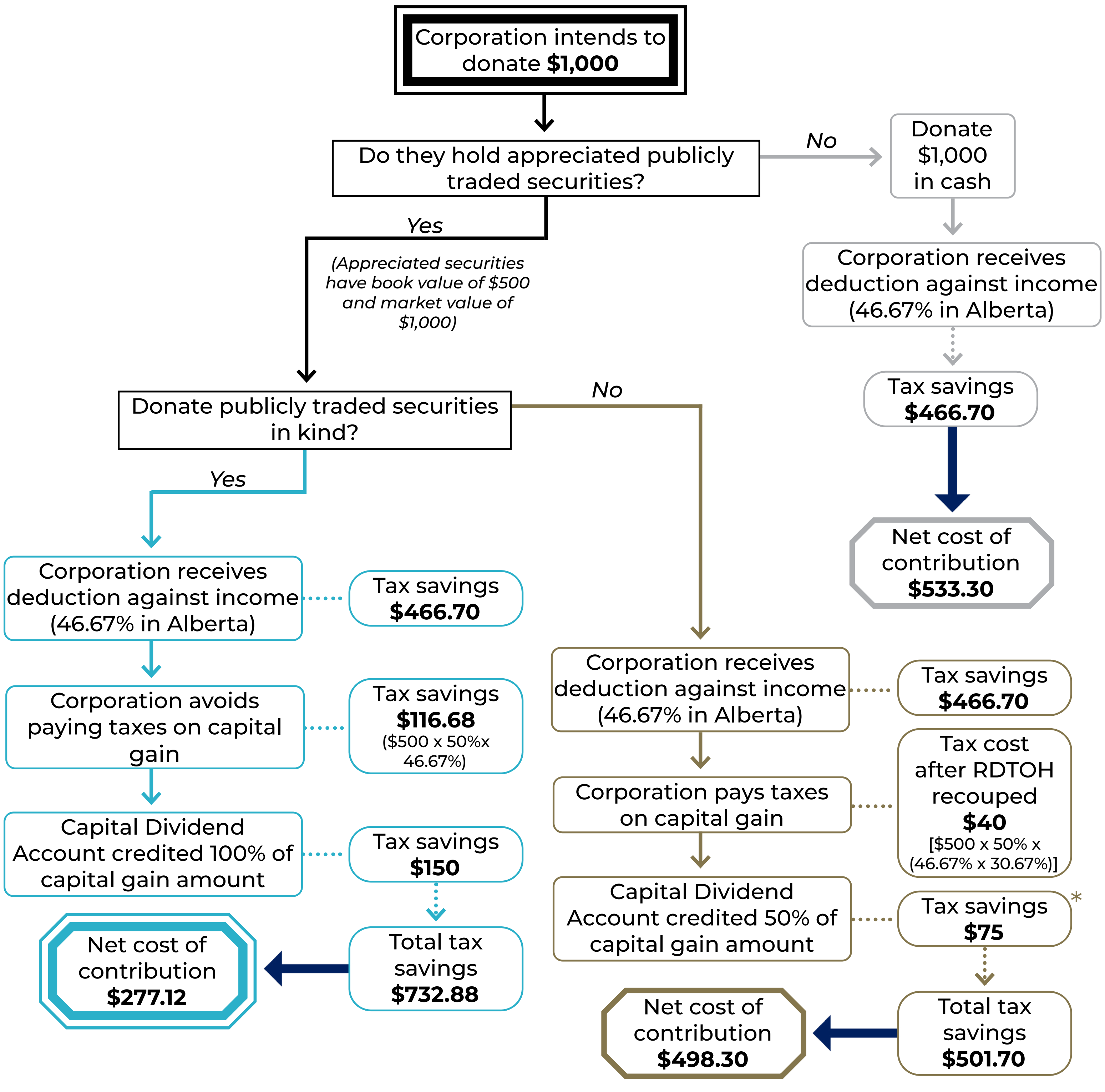
THE MUSTARD SEED

One of our clients recently asked that we process a donation of $1,000 to the Mustard Seed, a non-profit operating in Alberta and British Columbia. A donation of this size would enable the charity to provide 2,850 lunches for those experiencing homelessness and poverty. This level of generosity deserved a correspondingly high level of care when it came to determining the most tax-advantaged method for making the contribution.

We reviewed the client's account and determined that at the time, their shares of John Deere had the highest unrealized capital gain. With this information in hand, we then used CanadaHelps to initiate the transfer, sell the securities, transfer the proceeds to the Mustard Seed, and issue the charitable tax receipt for the donation. All that was required from our client was confirmation to proceed and a signed letter of direction. The process was seamless; the Mustard Seed received the donation promptly and our client saved a considerable amount of taxes.

Tax Planning for

Maximizing Corporate Charitable Donations



Assumes 30% marginal dividend tax rate

As you can see in this case, it would effectively cost just $277.12 to donate $1,000 to charity. Conversely, if the donation were made in a suboptimal manner, the total cost would range between $498.30 and $533.30, depending on the method employed.

Following the transfer, we were immediately able to repurchase shares of John Deere to ensure appropriate investment portfolio diversification was maintained since there are no timing limitations such as in the case of superficial stop-loss rules.

Sometimes you must give a little to get a little, but in a situation like this, you can get a lot more back than you might have previously thought. And then give some more, if you are so inclined.

In Conclusion...

DAF accounts are too valuable to overlook in any wealth plan. In addition to substantial tax incentives, depending on the approaches considered, DAF accounts can inspire future generations to adopt philanthropic perspectives and normalize years of high cash and tax planning activity. Accessing the expertise of our investment counsellors and portfolio managers working in tandem with your accountant will allow for the customization, and optimization, of such planning.

Unencumbered by alternative motivations, Qube will work with you to delve deep into your unique, personal circumstances and investment preferences, consider your specific financial goals, risk tolerance, and ongoing needs. Our team at Qube is committed to providing you with a holistic, diversified, and personalized investment experience. If you would like to learn more, reach out to us by email, or call us at (780) 463-2688.

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