

By Michael Berton

# TOOLBOX

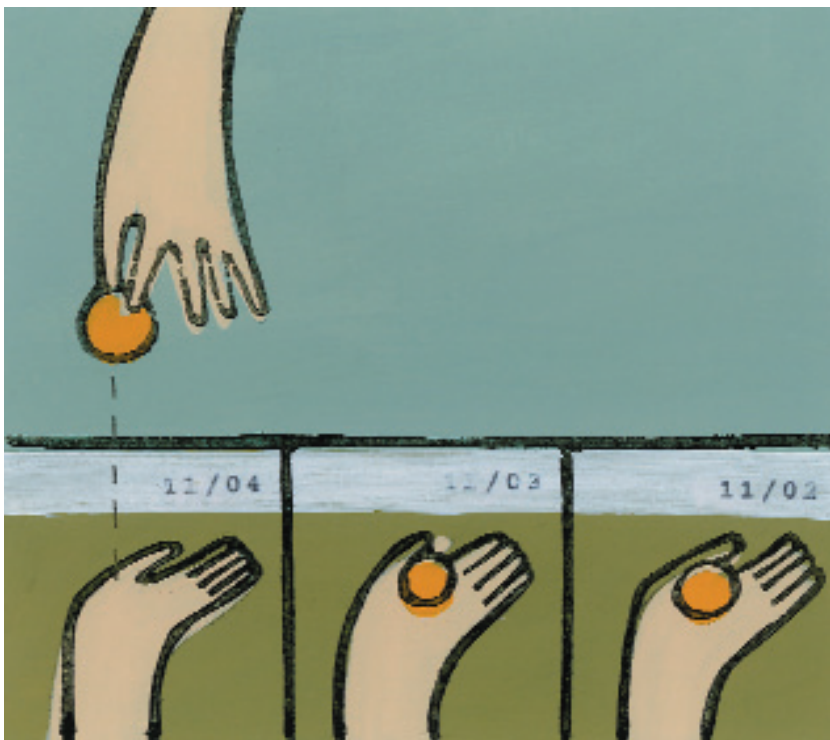
## PLANNED GIVING

A systematic approach to charity maximizes tax advantages.

**When I** review my clients' tax returns, I am disappointed to see how few actually donate a meaningful amount to charity. Thankfully, there are always some generous individuals who restore my faith in our collective sense of philanthropy.

Things are looking up too. Statistics Canada reported that Canadians donated more than \$5.8 million to charity in 2002—an increase of 6% from the previous year.

At a recent seminar, Mick Mulloy, director of fund development for the Calgary Foundation, made the distinction between charitable giving and philanthropy: Charitable giving is “direct, small and irregular cash contributions to charity.” Essentially, this is unplanned giving. Alternatively, philanthropy is “part of an organized, ongoing and long-term approach to gifting, designed not only to benefit the charity, but also to give the donor benefits such as current tax deductions, avoiding capital gains taxes and reducing estate and gift taxes.”



Major Canadian charities know individuals need assistance to make planned gifts. While many organizations have their own gift planners on staff, they also are reaching out to help financial planners become more knowledgeable. Advisors who

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wish to better assist their clients in achieving their philanthropic goals would be well advised to build relationships with the charities in their region.

Donors expect their advisors to provide expertise in the technical details of gift execution. Moreover, they want their advisors to acquire an understanding of the donor's personal motivations for giving, and to allow the donor to set the pace in the planned giving process.

In Canada, tax relief is an obvious financial motivation for philanthropy. The government allows Canadians a tax credit of 25% on the first \$200 donation and 50% on any excess amount. There is a claim limit based on 75% of individual net income in any taxation year. If donors overstep the limit, no problem—they can carry the excess donation amount forward for five years. Further, in the year of death, the limit is increased to 100% of net income plus a provision to carry back for one year any amount in excess of their net income in the year of death.

While most advisors study the tax-planning attributes of charitable giving, tax savings has been shown to be one of the weaker motivators for clients. Studies from the Canadian Centre for Philanthropy show some of the stronger motivators to be compassion (94%); belief in a cause (91%); personal experience with a cause (68%); love of their community (59%); and religious belief (25%). Further, clients are more likely to consider a charitable plan when they sell a business or significant interest, receive a sudden increase in wealth or experience a tragic or celebratory event.

There is also a trend towards more complex gifts such as stocks, stock options, insurance policies, flow-

through shares and even real property. Along with the complexity of the gifts, donors are looking for more ongoing control of their gifts and in some cases a giving strategy.

According to the CRA, there are more than 80,000 charities in Canada. Public foundations can fall into several subcategories including self-standing foundations such as the Canadian Women's Foundation, affiliated foundations (university, artistic or hospital foundations), and community foundations (Vancouver Foundation).

A community foundation or a specifically targeted foundation may offer your clients flexibility in gifting to multiple causes that share a commonality with the client, for example, in the area of geography or education. Alternatively, some donors may wish to provide their executors with the flexibility to determine the charities that will receive gifts after their death. In this case, the will could name a community foundation and include instructions to establish a fund with the donor's executors as granting advisors.

Charitable foundations offer a plethora of arrangements for the donations they receive, based on the source and needs of the donor. The most common forms of donations are endowed or flow-through funds. Endowment funds allow capital to be held for a specified period with an annual percentage distribution based on the fund's market value. Flow-through funds allow the capital and earned income to be fully disbursed over time for charitable use.

Mulloy demonstrates the power of endowment funds with the following example: Over the course of 100 years (three generations), a \$100,000 gift would result in gifts made to charity of more than \$3 million. At the end of the

period, the initial gift would have grown to an endowment of \$2 million, based on the foundation's historic track record, earning a 9% return, less 1% for costs, and a 5% annual grant. Advisors can assist their clients with a number of choices before giving a gift. For example, is it important to benefit the charity immediately or in the future? Do they have sufficient assets or income to support the gift? What level of involvement and comfort do they want to have with the charity and their gift?

## Types of Gifts

The easiest gift is cash. This offers the charitable foundation immediate funding that can be used to provide benefits while the donor receives immediate tax savings.

A charitable bequest is a gift made through a will. The will directs a specified amount or percentage of the estate residue to a charity or group of charities. Changes in the February 2000 federal budget allow charitable donors to name the charity directly as the beneficiary of an RRSP, RRIF or life insurance policy. The proceeds are not subject to probate tax or creditor claims.

Advisors might well add this detail to their wills, beneficiary designation and insurance review checklists. In order for the tax relief to apply, however, CRA requires the name of the recipient charity and the specified amount.

Gifts of life insurance policies or proceeds have always been an attractive way for Canadians to make a significant future gift at a modest cost. There are a number of options available:

- ❶ Purchase a life policy on your own life and immediately gift it to the charity, naming the charity owner the policy beneficiary.

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For example, Garcia, 46, wants to make a meaningful donation to her local symphony foundation but cannot afford the capital at this time. Instead she purchases a \$50,000 life insurance policy and names the symphony's charitable foundation as owner and pays the annual premiums of \$1,600 for five years. Each year, she receives a donation receipt for the premiums paid. Her tax credit is about \$800 (50%), so her out-of-pocket cost for the future \$50,000 gift is only \$800 per year.

## 2 Contribute an existing policy to the charity, making it the owner and policy beneficiary.

Ascertain the adjusted cost base of the policy in advance. If Lucy already owned a \$300,000 face amount policy with an ACB of \$40,000, and a cash surrender value of \$50,000, she would realize a capital gain of \$10,000, resulting in \$2,500 tax (assuming a 50% marginal rate). At the same time she would receive a charitable donation receipt for \$50,000, giving her tax savings of approximately \$25,000, and a net tax savings of \$22,500. Lucy would also receive tax receipts for future premiums paid on behalf of the foundation under the policy.

## 3 Retain ownership of the policy and designate the estate as beneficiary, placing instructions in the will to pay all or a portion of the proceeds to the charity.

## 4 Retain policy ownership and designate the charity as the beneficiary.

Gifts of appreciated securities offer the most cost-efficient option for donors. The reductions of the capital gains inclusion rate in 2000 combined with the special reduction permitted for qualifying gifts of marketable securities allow donors to realize only 25% of the capital gain while earning a charitable tax receipt for the full market value of the gift. This means that donors will not pay any tax on the appreciation of such gifts. The securities (publicly traded mutual fund units, segregated fund units, stocks, bonds, warrants, options) must be transferred to the foundation to qualify for the lower inclusion rate. Gifts to private foundations do not qualify for this treatment.

Joe and Mary Nichols want to donate \$100,000 to their community foundation. They could give either \$100,000 cash or XYZ shares with a fair market value of \$100,000 and a zero cost base,

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GIFT OPTIONS AND TAX IMPLICATIONS			
OWNER	BENEFICIARY	DONATION RECEIPT DURING LIFETIME	DONATION RECEIPT UPON DEATH
Foundation	Foundation	Cash surrender value at date policy is transferred, plus annual premiums	None
Donor	Estate	None	Amount of gift made in will
Donor	Foundation	None	Amount of insurance proceeds

Source: Toronto Community Foundation

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assuming an effective tax rate and donation credit of 50%. Rather than sell the

shares and donate cash, their advisor recommends they simply gift the securities to the foundation—a strategy that will

save them \$12,500. In the case of the donation of appreciated securities, the normal 75% of net income limit is eased to allow the full sheltering of the taxable portion of the gain.

Rather than gift assets, the donors could also consider a charitable remainder trust. Such a structure would irrevocably gift some or all of their assets to an *inter vivos* trust managed by a trustee.

Any net income would be paid to the donors until their deaths, at which time the assets would be distributed to the charity and a tax receipt would be simultaneously generated. The amount of the receipt would depend on the fair market value of the property, the donor's ages, and current interest rates. This strategy works better for clients over 65, as the tax relief is based on age (the older the donor, the higher the tax savings).

## SECURITIES OPTIONS AND TAX IMPLICATIONS

JOE AND MARY NICHOLS	SELL SECURITIES, THEN GIFT CASH	GIFT SECURITIES IN KIND
Gift received by charity (cash or in kind)	\$100,000	\$100,000
Taxable capital gain (50% if sold; 25% if gifted)	\$50,000	\$25,000
Tax re gift: (50%)	\$25,000	\$12,500
Donation tax credit: (50%)	\$50,000	\$50,000
Net tax savings after gift**	\$25,000	\$37,500
Net after-tax asset value given up	\$75,000	\$62,500
Tax savings realized by gifting securities in kind		\$12,500

Note: Gifts of appreciated securities may give rise to alternative minimum tax.

\*\*Tax savings can be used to offset the tax applied to other forms of income in the year.

A charitable remainder trust can also be established as a testamentary trust providing both protection and income to a surviving spouse and ultimate disposition of the assets to a charity.

Clients who rely on investment returns and are concerned about lower returns and higher taxes might do well to consider a charitable gift annuity. In this case, the donors would make an immediate gift to the charity, allowing the charity to arrange a commercial prescribed life annuity that would pay them a fixed income for their lives (single and joint options exist) at a similar income level to their investment returns. Excess capital over the amount required to purchase the income stream will flow immediately to the charity.

Depending on the age of the donors, a substantial portion of their resulting income may be tax-free due to the tax

treatment of prescribed annuities.

Once again, this strategy is most suitable to older clients (best results are achieved when the donors are over age 70).

This article only skims the surface of the issues concerned with planned giving. Advisors are strongly encouraged to refer to Frank Minton and Lorna Somers' self-published resource, *Planned Giving for Canadians: A Guide to Instituting & Managing a Successful Planned Giving Program*. **AE**

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