Charitable Donations: Before & After Death

In Canada, giving to charity has a strong sense of tradition. Over the past few years, making charitable donations by both individuals and their businesses has grown both in quantity and in scope. In addition to philanthropic reasons, the increase is partially a result of allowable tax benefits under the Income Tax Act; donors have become more sophisticated in how they support their charities.

Types of Donations

Cash Donations
Cash is the most common way of making a donation. Official receipts should include the charity’s name, address, registration number assigned by the Canada Revenue Agency (CRA), date of donation, receipt serial number, donor name and donation amount. Each receipt should also have a statement indicating it is an official receipt for income tax purposes.

In-Kind Donations
In-kind donations occur where property or services are provided to a charity for no remuneration. A property donation can be a personal property, assignment of life insurance, shares of private or public companies, etc. In addition to the conditions for cash donation receipts, in-kind donation receipts should include a description of the property donated, name and address of the appraiser, fair value of the property at the time of the gift and an eligible amount of the gift. It is more beneficial to donate capital property rather than selling the property and donating the proceeds.

Tax Credit for Charitable Donations
In general, tax credits for charitable donations are in the top marginal tax rate. A smaller credit applies to the first $200 of donations made in a given year. These tax credits are non-refundable and can only be used to reduce income taxes.

Reporting Donations
Eligible donations should be reported in the tax return for the year the gift was made, even if the total gift exceeds the annual donation limit. This helps to track any donation amounts carried forward and minimizes the risk of lost donation receipts. Donations not claimed in the year the gift was made can be used within the next five taxation years subject to the respective annual donation limits for those given years.

Charitable Donations: Tax Benefits During One’s Lifetime

Annual Donation Limit
Subject to few exceptions, the annual donation limit is 75% of net income. Generally, net income includes total income from all sources (e.g., salary, pension, investment income, etc.) Donations exceeding the annual limit can be carried forward for up to five years.
Shares of Public or Private Companies

If shares listed on a designated stock exchange are donated, you may be eligible for an inclusion rate of zero on any capital gains realized on such gifts. Donating shares of public or private companies is highly tax-effective. Donating flow-through shares generally result in better tax savings compared to donating regular shares provided the flow-through shares are qualified for the mining, renewable energy, oil and gas investment tax credits.

Charitable Remainder Trusts

In some situations, a trust can be used to donate property to a charity. A charitable remainder trust involves creating a trust under the terms of which a particular charity is named “capital beneficiary” and the donor is named “income beneficiary”. The donor then transfers one or more assets to the trust.

Under a written trust agreement, the trustees would hold the legal title to the property. As income beneficiary of the trust, the donor could be entitled to all income earned on the funds invested within the trust. The trust agreement would specify that, upon the donor’s death, the trust’s assets are to be transferred to the capital beneficiary charity. The donor avoids any capital gains tax on the donated assets and receives a tax deduction for the fair market value of the remaining interest that the trust earned.

One advantage of this arrangement is that a charitable tax receipt would be available at the time the trust is created while still receiving interest income from the investments during the lifetime. The tax receipt would allow you to be eligible for tax credits thereby reducing the overall tax burden. The disadvantage is that, to qualify for a charitable tax receipt, the capital cannot be returned to you. If the trust agreement allows you to receive capital from the trust, CRA mandates that the gift to the charity is not an eligible charitable gift.

Finally, such a trust might be used to hold real estate that is intended to be donated to the charity after the donor’s death. Under the terms of the trust agreement, the donor might retain the exclusive use of the property during his or her lifetime.

Charitable Donations: Tax Benefit Upon Death

Annual Donation Limit

In the year of death, the 75% annual donation limit increases to 100% of net income.

Gift by Will

In many cases, charitable bequests are included in an individual’s will. The executor(s) may deduct charitable donations made through the will on the terminal return by providing an official receipt; if the gift will be made at a later time, CRA will accept a copy of the will, a letter on behalf of the estate to the charitable organization advising of the gift and its value, as well as a letter from the charitable organization that includes its CRA-issued registration number acknowledging the gift.

Donating a Life Insurance Policy

Some people may be “worth more dead than alive” to the charities they support. This statement holds true when the donor has obtained additional life insurance and has designated the charity as the beneficiary. If you were to take out a life insurance policy and irrevocably designate a charity as the beneficiary, insurance premiums paid on the policy would be viewed as charitable donations for income tax purposes and would be
eligible for the donation tax credit. That said, an irrevocable beneficiary designation means the charity cannot be removed as the beneficiary under any circumstance.

Transferring ownership of an old whole life policy creates taxable income on the policy gain when the cash value exceeds the cost base of the policy. Fortunately, tax savings normally exceed the tax owing on the policy gain. Consideration should be given to hiring a qualified independent actuary to verify that the fair market value of the donated policy exceeds the cash surrender value (CSV). If, for example, you are in poor health, the charity can use the market value instead of the CSV for the amount of the tax receipt.

**Carry Back One Year**

Where tax credits are significant enough to eliminate all income tax payable on the deceased’s final tax return, there is an option to carry back, up to one year, any available unused tax credits in the year of death.

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**Tax Planning for Unused Donation Credits**

In the event of additional unused credits after the carry back, there are ways to increase the deceased’s net income by planning automatic RRSP and other non-registered investment rollovers. The estate can elect to withdraw or rollover the investments at fair value as of the date of death resulting in additional income in effort to use all remaining donation credits.

Using charitable donations in tax planning can be a highly effective tool resulting in a positive situation for both the donor and the recipient charity. By coordinating with the charity, donors can be confident that their generosity will have a positive and lasting effect on the charities and the communities they serve.

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