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Making the Most of Your Charitable Gifts for 2016

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Canada's tax incentives for charitable donations are designed to make it easier for you to support your favourite charities. The tax savings, starting in 2016, may be worth even more if you're in the new top tax bracket because your income is over $200,000.

Your after-tax cost for a $1,000 cash donation in 2016 can range from $460 to $523 if you have income over $200,000, and from $500 to $563 if your income is under $200,000, depending on your province of residence, as noted below.

Remember to make your charitable gifts by December 31, 2016 if you want to claim the donation credit on your 2016 tax return.

Once you've decided which charities to donate to, and how much you can afford to give, you may want to consider alternatives to making a cash donation. How you structure your charitable donations can be as important as the amounts you give, both to the charity and to the donation's after-tax cost to you. Gifts of property (known as "gifts in kind"), such as securities, artwork, real estate and life insurance can be tax-effective alternatives to gifts of cash.

This *TaxNewsFlash-Canada* discusses Canada's tax incentives to encourage charitable donations. We also highlight a variety of ways to structure your donations to make the most of these incentives both during your lifetime and through your will. For more tax planning ideas involving charitable donations, estate and will planning and other topics, see KPMG's *Tax Planning for You and Your Family*. The 2017 edition will be available soon in bookstores across Canada or directly from Carswell at 1-800-387-5351.

Charitable donations — Gifts that give back

Keep the following points in mind when considering your charitable donations. These points are discussed in more detail below.

- You will receive a 15% federal tax credit for the first $200 you donate for 2016. If you have income over $200,000, you may receive a 33% federal tax credit for your donations over $200. If your income is under $200,000, you will receive a 29% federal tax credit for donations above $200.
- Provincial tax credits may boost your total combined charitable donation tax credits up to 54% if you have income over $200,000 and up to 50% if your income is under $200,000.
- Donating securities instead of cash may increase the benefits of the donation for you and the charity.
- If you make bequests in your will, consider new rules and all the options for maximizing the tax credits and the funds available to your estate and your beneficiaries.
- Gifts of life insurance can finance a sizable donation with a relatively small cash outlay, depending on the level of your premiums.

If your donations add up to more than 75% of your total net income (or 100% for certain "gifts in kind"), you can carry forward the excess amount and claim it in any of the following five years.

Tax credits for charitable donations

As an individual donor, your charitable donations entitle you to a three-tier tax credit. The first $200 of annual donations produces a 15% federal tax credit, plus the applicable provincial credit. Donations above that level produce a 29% federal tax credit, worth 43.7% to 50.0% when provincial tax credits are factored in, assuming your income is under $200,000 (see "Regular rate" in the table below).

If your income is above $200,000, you can get a 33% federal tax credit, worth 47.7% to 54.0% when provincial credits are factored in, for the portion of your donation above $200 that equals your income over $200,000, starting in 2016 (see "High rate" in the table below).

The new 33% federal donation credit applies for 2016 and later years. Donations carried forward from 2015 or prior years will not be eligible for this higher credit rate.

For example, say you live in B.C. and your income is under $200,000. If you donate $1,000 to charity in 2016, you will get a combined federal and provincial tax credit of 20.1% on the first $200, equalling about $40. For the remaining $800 of the donation, you'll get a combined credit of 43.7%, equalling about $350. As such, your total federal and provincial tax credit will be $390, and the after-tax cost of your $1,000 donation will be $610. If you donate another $1,000, you'll get a 43.7% credit for the whole amount, and the after-tax cost will be $563.

Combined Federal and Provincial Tax Credits for Donations Over $200 in 2016				
Province	**Combined Federal/Provincial Credit**		**After-tax cost of $1,000 donation in 2016**	
	Regular rate	**High rate**	**Regular rate**	**High rate**
British Columbia	43.7%	47.7%	$563	$523
Alberta	50.0	54.0	500	460
Saskatchewan	44.0	48.0	560	520
Manitoba	46.4	50.4	536	496
Ontario	46.4	50.4	536	496
Quebec	48.2	51.6	518	484
New Brunswick	47.0	51.0	530	490
Nova Scotia	50.0	54.0	500	460
P.E.I.	47.4	51.4	526	486
Newfoundland	45.8	49.8	542	502

Gifts in kind — Donating shares and other assets

Donations of property other than cash are called "gifts in kind." To determine the tax credit for your donation, a gift in kind is generally valued at its fair market value at the time you make the gift. You are also, however, deemed to have disposed of the property at that fair market value, meaning that you must recognize any gain or income that would arise as if you had sold the property at that amount.

In the case of a donation of capital property such as artwork, shares or real estate, you may make an election to designate a value for the gift anywhere between its cost to you and its fair market value to avoid triggering a capital gain or to trigger a smaller one. The tax credit for your donation will be based on the value you designate between your cost and the asset's fair market value.

The tax system also includes special incentives to encourage gifts of "certified cultural property" and donations of ecologically sensitive lands to the federal government, a province, territory or a municipality, or certain charities.

Donating publicly traded shares

Donations of eligible securities to charities, including securities listed on prescribed stock exchanges, mutual funds and segregated funds of life insurance companies, are exempt from the capital gains rules; you do not have to include any of the resulting capital gain in income. As such, you pay no tax on any gain inherent in such securities.

These rules apply to donations of securities to private foundations as well as public charities, though private foundations are subject to tighter restrictions on the amount of stock they can hold in a corporation.

Cash vs. securities — Which should you donate?

If you want to make a charitable donation in 2016 and you have eligible securities that originally cost you $1,000 and are now worth $2,000, should you sell the securities and donate the proceeds, or should you simply donate the securities directly to the charity? Assuming you live in Ontario and are taxed at a marginal rate of 46.4% (i.e., your income is about $150,000), and you've already donated $200 in the year, the tax effects of both choices are set out below with the results summarized in the chart below.

If you sell the securities and donate the before-tax proceeds, a $1,000 capital gain will arise on the sale ($2,000 proceeds - $1,000 original cost). You would then have to pay $232 in tax on the taxable portion of your gain (50% of $1,000 × 46.4% assumed tax rate). Your $2,000 donation will give you a tax credit of $928 (46.4% × $2,000). In the end, the donation will result in net tax savings of $696 ($928 tax credit - $232 capital gains tax).

On the other hand, if you donate the securities directly, the charity will still get the full $2,000 value, and the taxable portion of the $1,000 capital gain will be tax-exempt to you. You will still get a tax credit of $928 for the donation (46.4% of $2,000). The net tax savings resulting from your donation in kind will be $928, or $232 more than if you sold the securities and donated the before-tax proceeds.

Example — Donation of Cash vs. Securities

This table below summarizes the results in our example of a donation made in 2016 with the proceeds from the sale of securities versus the direct donation of the same securities.

Example — Donation of Cash vs. Securities		
	Sell securities and donate proceeds	**Donate securities**
Value of donation (A)	$2,000	$2,000
Cost base (B)	$1,000	$1,000
Capital gain (A – B = C)	$1,000	$1,000
Capital gain inclusion rate (D)	50%	0%
Taxable capital gain (C × D = E)	$500	$0
Tax on E (assuming 46.4% marginal rate)	($232)	$0
Donation tax credit (A × 46.4%)	$928	$928
Net tax savings (F)	**$696**	**$928**
Net after-tax cost of donation (A – F)	**$1,304**	**$1,072**

As you can see, you will come out ahead in this scenario if you donate the securities directly. In this example, you give up property of the same value and your tax savings increase by $232. Looking at it another way, the after-tax cost of your donation is reduced by $232 to $1,072 (from $1,304) when you donate the shares directly.

Donating shares acquired through employee stock options

If you're an employee and you donate public company shares acquired under a stock option plan to a registered charity, an additional deduction is available that effectively reduces the related income inclusion to nil, the same as would apply to a capital gain realized on the donation of other shares. To qualify, you must donate the shares to the charity within 30 days of the share acquisition (and in the same taxation year) under the stock option plan.

Donating private company shares and real estate

A measure was proposed in the 2015 federal budget to provide a tax exemption for capital gains on some dispositions of private company shares or real estate when the cash proceeds from the disposition were donated to charity within 30 days. The government stated in the 2016 federal budget that it does not intend to proceed with this measure.

Charitable bequests and legacies

New rules for charitable giving by will

If you have made charitable bequests in your will, new tax rules generally provide greater flexibility to use the tax credit for your donations as well as gifts by direct designation, such as RRSP or life insurance proceeds, as of January 1, 2016.

The new rules will allow a donation to be allocated between the deceased and his or her estate for purposes of the charitable donation tax credit, as long as the donation is made by a qualifying estate, known as a "graduated rate estate". Where applicable, the deceased may claim a donation in the year of death or in the immediately preceding year, up to 100% of the deceased's income. Alternatively, a qualifying estate may claim the donation in the year of the donation, carry it back to any of its prior taxation years, or carry it forward for up to five years, up to 75% of the qualifying estate's income.

The revised rules also deem gifts made by will or by an estate to have been made by the estate at the time that the gift is actually transferred to the charity, rather than as of the date of death.

The new rules continue to provide an exemption from capital gains taxation on gifts of publicly traded securities, as long as the gift is made by a qualifying estate.

If a donation is made by a non-qualifying estate, then a donation can only be claimed in the year the gift is made or in the five subsequent years.

For details, see KPMG's *TaxNewsFlash-Canada* 2016-03, "New Estate and Trust Tax Regime — Welcome Relief Announced".

The CRA's past practice of allowing a surviving spouse (or common-law partner) to claim a donation made by the will of the deceased spouse in the surviving spouse's return in the year in which the death occurred no longer applies for deaths occurring in 2016 and later years.

Gifts of life insurance — A good policy

Another tax-effective way of contributing to a charity is through the donation of a "whole life" insurance policy — a policy that combines pure insurance with an investment fund. To make the donation, the ownership of the policy is transferred to the charity and the charity becomes the beneficiary of the policy.

For tax purposes, the value of your donation is generally the policy's fair market value, minus any policy loan outstanding. However, to the extent that value exceeds the tax cost of the policy to you, you must recognize the excess as income, as if you had cashed in the policy.

Once you have donated the policy to charity, if you continue to pay the premiums, rather than having the charity pay them, each payment will be considered an additional charitable donation entitling you to a tax credit. If you name a charity as the beneficiary of your life insurance (or your RRSP or RRIF) in your will, your qualifying estate may be able to claim the amount as a charitable donation in your final tax return or the return for the preceding year. The new rules for charitable giving by will also apply to these donations for deaths occurring after December 31, 2015.

Donations made by corporations

If you own a corporation, you may want to consider having the corporation make a donation. While individuals get tax credits, corporations can deduct donations made in determining taxable income, within specified limits. If your private corporation donates securities or other capital property, the corporation's capital dividend account will be increased by the non-taxable portion of the capital gain, and this amount can then be paid out to the corporation's shareholders tax-free. Be sure to compare the results of donating personally or through your corporation as lower corporate tax rates may make it more beneficial to make the donation personally.

Proceed with caution

Income limit for charitable donation claims

The maximum amount of donations you can usually claim in a year is 75% of your net income. To the extent you have receipts for more than this amount, or if you choose not to claim a donation in the year you made it for other reasons, you can save the receipts and generally claim the credit in any of the following five years.

For purposes of the tax credit, the 75% net income limit is effectively increased to 100% of net income for:

- Donations of capital property resulting in taxable capital gains
- Donations of depreciable property that trigger recapture of capital cost allowance (i.e., tax depreciation)
- Gifts of ecologically sensitive lands (including a servitude, easement or covenant) to the federal government, a province, territory or a municipality, and certain charities
- Gifts of "certified cultural property" (and capital gains on such property are generally not taxable).

Watch out for alternative minimum tax

If you already have certain large tax deductions or capital gains in a year from other dispositions, making a donation as a gift in kind that triggers additional significant capital gains could result in a liability for alternative minimum tax (AMT). Before you make such a donation, be sure to crunch the numbers (or ask your tax adviser to do so for you) to ensure that AMT does not arise.

We can help

Your KPMG adviser can help you to improve the financial benefits of your gift to your chosen charity and the tax benefits to you or your corporation. We can also assist you in reviewing your will to help ensure that your charitable bequests will be made as you intend and are tax-effective for your estate.

Careful planning together with your KPMG adviser can ensure that you make the most of the tax incentives for charitable donations while ensuring that your philanthropic goals are met.
