Charitable Giving

If you wish to leave your mark on the world by contributing to a worthy cause, there are many options available to you. Many of your charitable giving options not only allow you to contribute to meaningful causes, but can lower your income tax payable (often resulting in more spendable income during your lifetime) and reduce the probate fees levied on your estate.

The following are brief descriptions of the opportunities and incentives in place for you to make a positive contribution to your chosen cause, in increasing order of complexity.

A Gift Of Securities

From a tax standpoint, a donation of securities directly to a charity (known as a "gift in kind") is more advantageous for you than selling the same securities and subsequently donating the funds. The advantage arises from the fact that donating securities to a charity entitles you to capital gains inclusion rate of 0% (instead of the usual 50%) upon the disposition of the securities. This means that upon donation of the securities, no taxable gain occurs. The following example serves to illustrate the benefit of contributing securities as opposed to the cash proceeds of a securities sale:

Sale of shares purchased 10 years ago, and donation of cash proceeds to charity:

Cost base of shares: $5,000
Fair market value of shares: $10,000
Total capital gain: $5,000
Taxable capital gain (inclusion rate of 50%): $2,500
Tax payable on gain (personal tax rate of 46%): $1,160
Donation receipt: $10,000
Charitable tax credit at 46%: $4,641
Net tax saving (charitable tax credit minus tax payable on gain): $3,481

Direct donation of shares to charity:

Cost base of shares: $5,000
Fair market value of shares: $10,000
Total capital gain: $5,000
Taxable capital gain (inclusion rate of 0%): $0
Tax payable on gain (personal tax rate of 46%): $0
Donation receipt: $10,000
Charitable tax credit at 46%: $4,641
Net tax saving (charitable tax credit minus tax payable on gain): $4,641

As you can see, you would save an additional $1,240 in taxes by contributing your shares directly to a charity as opposed to selling the shares and subsequently donating the proceeds of the sale.

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Bequests Under A Will

A bequest is a direction in your will that a certain sum of money, a particular asset or a portion of the estate is to be given to a selected charity. It allows flexibility in planning your financial affairs because the gift is not received until the end of your lifetime.

A bequest has tax benefits for your estate as well. A donation receipt for the amount donated to the charity will be issued to your estate. You will receive a credit against your estate's taxable income for 100% of the amount donated, and the credit can be carried back one year (to a maximum of 100% of net taxable income). Thus, assuming a 46% tax rate, your bequest will have a net cost to your heirs of about half of the donated amount.

Gift Of A Life Insurance Policy

A gift of life insurance benefits is a way of making a gift without depleting your estate or depriving your loved ones of other assets. The main advantage of using life insurance as a gift is that ultimately, the value of the insurance benefits payable to the charity will be substantially greater than what you paid for the policy. The policy can be paid for with small regular payments out of your current income rather than your assets. Upon your death, your gift of the policy benefits will be paid by the insurance company directly to your named charity. Since the proceeds do not form part of your estate, there are no probate or administration fees and creditors or family members cannot contest your gift.

Upon your death, the charity will provide your estate with a charitable tax receipt for the amount of the death benefit. Your estate then benefits from a tax credit based on the marginal tax rate of the estate (usually around 50%), which will reduce your net taxable income in the last two years of life.

Another method of donating a gift of life insurance involves changing the beneficiary and owner of your existing policy to your chosen charity. The charity would issue you a charitable receipt for the cash surrender value of the policy and any accumulated dividends. In addition, any premiums that you continue to pay on this policy will be considered a charitable donation and thus you will be provided with charitable receipts in each year that you pay the premiums. The resulting tax credits can effectively halve the cost of the insurance to you, while your chosen charity will still receive the full benefit of the policy.

However, it is important to remember that the value of the policy will be considered income in the year that ownership changes. While the charitable tax receipt will offset the tax owing on your income, your eligibility for any means-tested social programs that you are registered in will be affected by the sudden "increase" in your income. Hence, changing ownership of your life insurance policy is not something you want to undertake without careful consideration.

Charitable Gift Annuities

A charitable gift annuity is an investment that generates regular payments to you for life.

Each payment is a blend of principal and interest, and thus generates greater after-tax income than many other investments that only pay interest income. There are two types of charitable gift annuities: **self-insured** and **re-insured**.

Self-insured: in exchange for a contribution, the charity contracts to make fixed, guaranteed payments to you for life. The charity invests the contributed assets and guarantees the payments, pledging its own resources as security. Upon your death, any remaining funds in the original contribution are used for the charity's own intended purpose. If you should outlive the funds in the original contribution, the charity would be obligated to tap into its general funds in order to continue the payments.

Re-insured: these types of charitable gift annuities are the most common. In exchange for a contribution, the charity contracts to make fixed, guaranteed payments to you for life. But in the case of a re-insured annuity, the charity purchases an annuity from a commercial insurance company, and retains any amount in excess of what is required for the purchase of the commercial annuity. Typically, the charity retains 25% to 30% of the contributed amount and uses the balance to purchase the annuity.

For both types of annuities, you will receive a tax deduction for the excess between the original contribution and the sum of the annuity payments to be paid during your expected lifetime. Your expected lifetime is based on actuarial tables, and how long you actually live will not affect your tax receipt. In addition, a substantial portion of your annuity payments will be free of tax.

The proportion of your annuity payments that is tax-free is calculated by dividing the total amount contributed by the total annuity payments paid during your expected lifetime. If the result is 1.0 or greater, the entire annuity payment is received tax-free.

Endowment Funds

An endowment fund is an investment of capital to provide a steady and dependable source of income for a particular charitable cause. Establishing an endowment fund is a statement of what is important to you and can create a perpetual legacy in your name.

Once established, additions of any amount can be made to the endowment fund, either during your lifetime or through your will or gift of life insurance.

Usually, the services of professional trustees and money managers are used to oversee the funds in an endowment. The capital in an endowment fund may not be withdrawn for a minimum of ten years from the time the fund is established. If you wish, the capital can be held in perpetuity.

If an endowment is established (or supplemented with a gift) during your lifetime, you will receive a donation receipt. The donation receipt entitles you to a tax credit which can be used to offset income tax payable on up to 75% of your net income in the year of the gift. Any unused credits may be claimed for an additional five years.

If an endowment is funded through a gift in a will or life insurance policy, the donation receipt generates a tax credit which can be used to offset income tax payable on up to 100% of your net income in the year of death. Any unused credits can be carried back and claimed against your income in the year prior to your death.

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Charitable Remainder Trusts (CRT)

If you have accumulated significant capital which you do not expect to use during your lifetime, you may wish to consider establishing a Charitable Remainder Trust (CRT). In order to form a CRT, you create an irrevocable trust funded by assets such as cash or securities, and name a trustee who will hold and manage the assets. Your chosen charity is the ultimate beneficiary of the CRT.

Once you have established a CRT, you or a designated beneficiary receives the income earned from the trust, either for life or for a specified number of years and without the management responsibility. At the termination of the trust, the balance of the principal (the "remainder interest") is distributed to the charity or foundation.

Because the gift does not form part of your estate, it is less susceptible to a challenge by heirs or creditors than a gift stipulated by your will. It also reduces the amount of your estate that is subject to probate and administration fees upon your death.

At the time you create a CRT, you will be deemed to have disposed of the remainder interest in the trust and may incur a capital gain. You will receive a donation receipt for the present value of the remainder interest, which from that point forward will belong to the charity. Any further capital gains will accrue to the charity tax-free. If you have to pay any capital gains tax on this disposition, it will be more than offset by the tax credit.

The "present value" is determined by an actuary, taking into account the market value of the assets, current interest rates and your life expectancy. The tax credit generated by the gift can offset the tax otherwise payable on up to 75% of your net income in the year of the gift, with a five-year carry-forward period for unused credits.

Example: Mrs. Goodheart contributes $200,000 to a CRT, naming her favourite charity as the beneficiary of the remainder interest. **Mrs. Goodheart will continue to receive the income from the trust for her lifetime**. Taking into account her age and other variables, an actuary determines that the present value of her contribution to the CRT is $88,000. Mrs. Goodheart will receive a donation receipt for $88,000, resulting in a tax credit to her of approximately $44,000 (assuming a 50% marginal tax rate). She may claim this credit on her tax return this year, and can carry forward any unused credits for up to five years.

The advantages to Mrs. Goodheart:

- She continues to receive the income from her contribution during her lifetime.
- She will receive a tax receipt which can be used to offset income in the year of the contribution and possibly the next five years.
- She gains the satisfaction of knowing that upon her death, her chosen cause will benefit from the principal and any further capital gains on a tax-free basis.
- Her gift is shielded from challenges by heirs or creditors, and reduces the amount of her estate that is subject to probate and administration fees.

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Combining A CRT With Universal Life Insurance

You can use the income and tax savings from a CRT to purchase a Universal Life policy. The face amount of the policy can be set to the amount you originally contributed to the CRT. Thus, upon your death, the policy benefit amount would be paid tax-free to your beneficiaries, effectively replacing the assets that you contributed to the charity through your CRT.

Of all the charitable giving vehicles available, CRTs are the most complex. You should contact your Raymond James Estate Planning Advisor, as well as your lawyer and accountant in order to determine if a charitable remainder trust is the best planned giving option for you.