THE GLOBE AND MAIL

CESTNICK

TAX MATTERS

Ramp up your tax savings from gifts to charity

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There's a guy I know who hates to pay tax. He tends to get a little aggressive with his tax deductions. When he was younger, he earned a little money doing some modelling, but he had an overbite, which caused him to lose some potential work, so he deducted the cost of clarinet lessons because, evidently, playing the clarinet can improve certain orthodontic issues. Then, later in life, he tried to deduct his kids' allowances as a business expense. You get the idea.

I finally shared with him an idea that can create big tax savings but is a legitimate deduction and can help other people at the same time. I'm talking about donating securities from a corporation. You see, if you have a corporation in your life that holds some investments, this idea could be for you.

THE RULES

If you choose to donate investments to a charity, rather than cash, two things happen from a tax point of view. First, you'll be deemed to have sold those investments at fair market value. In the distant past, this could create a taxable capital gain if the investments had appreciated in value. The second implication is that you'll be entitled to a donation receipt, and tax relief, for the value of the investments you donate – which is great.

Now, there's more good news to share. It was back in 2006 that the government changed the rules around donations to make it more attractive to donate publicly traded securities than cash. Today, if you donate these types of securities to charity, our tax law will set the capital gains inclusion rate on those securities to zero. Normally, the inclusion rate is 50 per cent, meaning that you'll face tax on one half of any capital gain realized on a disposition (including a donation) of assets that have grown in value.

And so, with an inclusion rate of zero, donating publicly traded securities today will eliminate the capital gains tax bill on those securities. In addition, you'll be entitled to a donation receipt for the fair market value of the securities donated. So, it's a double benefit. We can turn this into a triple benefit if we donate securities from a corporation. Let me explain.

THE STORY

Let's consider Jason. He has a holding company with a portfolio of publicly traded securities. Jason wants to save some tax this year, but also wants to help charitable causes that he believes in. Given the challenge that many charities are facing today, he's decided to make a gift of $100,000 from his company.

In his portfolio, there's a particular security – stock in XYZ Corp. – that has appreciated in value. He bought shares of XYZ at $40 a share, and today they're worth $100. So, he wants to donate $100,000 of his XYZ shares to charity. The adjusted cost base of the shares he'll be donating is $40,000. Making the donation of these shares will trigger a $60,000 capital gain. The good news? Jason's company won't pay any tax on this capital gain because the inclusion rate is zero for those donated securities, meaning that no part of the gain is taxable. In addition, his company will be entitled to a tax deduction for the $100,000 value donated. This will save his company $51,200 in taxes this year at the average tax rate for corporations on investment income in 2020 (the actual rate varies by province).

But let's not forget about the tax savings from the tax-free capital gain. That gain would have attracted taxes of $15,360 ($60,000 capital gain times the 50-per-cent inclusion rate, times an assumed tax rate of 51.2 per cent), but these taxes are avoided thanks to the donation.

Now, for the triple tax benefit. Every corporation has something called the "capital dividend account" (CDA). If your company has a positive balance in its CDA then you can pay tax-free capital dividends to yourself, up to that amount. The CDA is increased by the tax-free portion of any capital gain.

So, in Jason's case, the $60,000 tax-free portion of his capital gain from the donation increases his CDA balance and allows him to withdraw $60,000 tax-free from his corporation. The tax that would have otherwise been paid by Jason on a dividend of $60,000 is $26,454 (at an average tax rate on ineligible dividends of 44.1 per cent; the actual rate varies by province).

To sum it up: The immediate tax benefits from donating $100,000 worth of securities in Jason's case are about $93,014 ($51,200 from the deduction, plus $15,360 from the tax-free capital gain, plus $26,454 from the tax-free capital dividend). His after-tax cost of the donation is just $6,986 ($100,000 less $93,014) in this example. It could cost just pennies on the dollar to help the charities important to you.

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