THE GLOBE AND MAIL

CESTNICK

TAX MATTERS

This holiday season, don't be like Scrooge and give to charity

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Let me ask you a question. Why does Scrooge love Santa's reindeer? Because every buck is dear to him. Groan. Okay, that's a really bad dad joke, I know. This month, please don't be like Scrooge. It's time to be generous because the need is greater than ever.

According to The Giving Report 2022 – a survey published by CanadaHelps.org, the proportion of Canadians who have participated in giving to charity declined from 24.6 per cent in 2006 to 19 per cent in 2019 – even before the impact of the pandemic and the current economic uncertainty resulting from high inflation and increasing interest rates. Yet, charities fill an important need in our communities, with 22 per cent of Canadians expecting to rely on charities for basic necessities over the next six months, according to the survey.

So, here's the challenge: If you have the means to give, please make it a priority this year. And if you're one of the fortunate who have made a significant profit selling a major asset this year, like real estate or a business, for example, consider the difference you can make by committing to a larger gift than you might normally. Let me share an example of what this could look like.

The story

Warren (not his real name) sold a rental property this year. He purchased the property for $400,000 several years ago and sold it for $1-million, for a capital gain of $600,000. He's expecting to pay taxes of $150,000 on his capital gain, assuming a marginal tax rate of 50 per cent and that one half of capital gains are taxable. This will leave Warren with $850,000 ($1-million minus $150,000) after taxes.

Given the large cash proceeds he received this year, Warren recognizes that he has an unusual opportunity to make a difference in his community while reducing his tax bill at the same time. So, he's decided to make a donation to fully eliminate his taxes from the sale.

He's going to do this by donating to a foundation that will, in turn, help various charities. If he donates $300,000 of the $1-million proceeds, he'll be entitled to a donation tax credit worth about $150,000 which will eliminate all his taxes on the sale, so he'll end up with $700,000 in his pocket after the donation. As an aside, the exact tax savings from a donation will depend on your province of residence and income level, but Warren's savings of 50 per cent are pretty typical for someone in the highest tax bracket anywhere in the country.

If we compare the no-donation and donation scenarios, he'll have $150,000 ($850,000 minus $700,000) less in his pocket if he makes the donation, but he will also have added $300,000 to the foundation. Another way to think about it: The taxman is participating with Warren in the donation, covering half of the amount he chooses to donate. So, while the foundation ends up with $300,000, it costs Warren just $150,000.

Warren could simply donate his money directly to one or more registered charities this year. In his case, he hasn't had a chance to think fully about which charities he wants to support. So, he has set up a Donor Advised Fund (DAF) at his local community foundation (you can use any public foundation that sets up DAFs; there's still time to do this in 2022 if you act now).

A DAF looks and feels like his own private foundation in that he can donate before year-end, receive the donation receipt in 2022, then distribute funds from the DAF to specific charities soon – perhaps early in 2023 after he's had the chance to think more about what causes are important to him, which charities help those causes, and how much each charity should receive.

Warren sells a rental property: Two scenarios

		No donation	Donation
A	Proceeds of disposition	$1,000,000	$1,000,000
	Adjusted cost base	$400,000	$400,000
	Capital gain	$600,000	$600,000
	Taxable capital gain (50%)	$300,000	$300,000
	Marginal tax rate	50.0%	50.0%
B	Taxes owing on capital gain	$150,000	$150,000
	Donation amount	–	$300,000
C	Donation tax credit	–	$150,000
D	Net taxes owing **(B minus C)**	$150,000	–
E	Cash-in-hand	$850,000	$700,000
F	Amount in foundation	–	$300,000
	Cash-in-hand for both donor and charity **(E plus F)**	**$850,000**	**$1,000,000**

THE GLOBE AND MAIL, SOURCE: OUR FAMILY OFFICE INC.

The add-on

Warren also decided to replace the capital that he's giving to charity through a $300,000 life insurance policy that will eventually replenish the estate upon death. The insurance policy will be issued jointly on the lives of Warren and his wife (this is a cheaper way to buy insurance because the policy won't pay out until both he and his wife have passed away).

Since the couple doesn't want the cost of the insurance premiums to affect their cash flow, their insurance adviser has arranged for a bank to lend them the funds to cover the premiums each year. When the second spouse dies the insurance will first pay off the loan at the bank, then $300,000 will be left over to replenish the estate. They're also structuring this so that the interest costs and the net cost of pure insurance are deductible. While adding this insurance idea to the donation isn't necessary, Warren sleeps better at night having done this. Speak to a tax pro and insurance adviser for more on this strategy.

Tim Cestnick, FCPA, FCA, CPA(IL), CFP, TEP, is an author, and co-founder and CEO of Our Family Office Inc. He can be reached at tim@ourfamilyoffice.ca