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TAX MATTERS

Proposed tax changes in Canada could stifle large charitable gifts

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I know, I know. It's not December yet, so why am I talking about charitable giving? Well, the needs in the community and among charities don't wane in the summer months, though donating often does. And to make matters worse, there are looming changes to our tax law that will undoubtedly affect the level of large gifts that are made to charities in this country.

Twenty-five years ago, in 1998, 25.8 per cent of Canadians claimed donations on their tax returns. In 2021, that figure was just 17.7 per cent – and the percentage continues to decline.

The good news? The total amount of donations has increased over that time to $11.8-billion from $4.3-billion. That's because the number of very large donations, generally made by wealthier Canadians, has increased over the years. In fact, the rise in the level of gifts has exceeded inflation by more than double over that time.

So, it would seem inappropriate to introduce tax laws that would negatively affect donations from wealthier folks. After all, tax rules that encourage charitable giving are not loopholes or tax schemes to somehow enrich the wealthy. When a person donates to charity, it costs them real money out of their pocket – even after the tax incentives.

The Changes

In 2006, the government introduced rules to encourage Canadians to donate publicly traded securities to charity. The rules eliminate the taxable capital gain on these securities when they're donated. In addition, the donor is entitled to a donation tax credit for the value of the gifted securities.

This is changing for donors earning more than about $173,000 starting Jan. 1, 2024. The 2023 federal budget introduced rules that will increase the tax cost of donating qualifying securities to charity. Specifically, any capital gain on these donated securities will no longer be tax-free, but rather 30 per cent of the capital gain will now be taxable. But there's more. The donation tax credit, which would normally be available for this generosity, will be cut in half.

These rule changes are part of broader proposals around something called the "alternative minimum tax" (AMT). The AMT is a tax calculation that is done side-by-side with your regular tax calculation, but under the AMT you're allowed fewer deductions, exemptions, and credits. If your AMT tax amount is higher than your regular tax, you'll be liable to pay the AMT amount.

You may be able to recover the extra tax paid over a seven-year period since the AMT can be claimed as a credit (in which case, the AMT is a prepayment of tax). But you could have a problem recovering this AMT if you're regularly claiming the same types and amounts of deductions and credits each year.

The Impact

Let's consider an example. Henry is a generous person who has been very successful financially and is in the top tax bracket in Ontario. He's done well in the stock market in the past and has decided that he wants to donate a total of $1-million of stocks to several charities sometime next year. Let's assume he has sufficient income to use up any donation credits he'll be entitled to claim.

For this example, let's say Henry has an annual income of $1.33-million. Under the current rules, Henry's total tax bill (federal and Ontario) on his income next year would be $672,050 less a donation tax credit of $495,200, for net taxes of $176,850. Under the proposed rules, his tax bill for next year would be $261,350, or $84,500 more because of the changes.

If you do the math under the new rules, the extra tax can be as high as 10 per cent of the donated amount. In Henry's example, the extra tax was 8.45 per cent ($84,500 on $1-million) of his donation.

The actual additional tax a person would owe under the new rules will vary depending on their province, the capital gain on the securities donated, and their level of income.

Okay, so you don't have $1-million to donate. Consider a gift of, say, $200,000 – which is not uncommon for higher-income individuals donating out of their assets – and an annual income of $300,000. In this example, the extra tax under the new rules will be $8,200 in Ontario. That's enough to make a sizable difference for a small charity in your community.

The point is that charities need all they help they can get, and higher-income Canadians have been driving the increase in giving over the last 25 years while the number of donors has declined. The changes proposed are a step in the wrong direction. Our federal government is not known for leading by example when it comes to tax policy worldwide – we often copy the United States or other countries – but in the case of discouraging donations from wealthy individuals, we stand alone.

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