THE GLOBE AND MAIL

CESTNICK

TAX MATTERS

Make the most of donation tax savings while giving back

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Tuesday of this week was Giving Tuesday – a day given its name by a global non-profit that promotes charitable giving. If you missed it, it's not too late to make donations for 2023. Let me share some tips for making your donations even more tax-effective.

Donate Securities

Donating securities rather than cash often makes sense. Consider Cathy. She has $10,000 worth of shares in ABC Inc. and has decided that it's time to sell them. She paid $4,000 for the shares, so she has an unrealized capital gain of $6,000. Cathy is also considering a donation to charity using the value of her ABC shares for the gift.

If Cathy were to sell her ABC shares, she'd pay taxes of $1,606 given that she's in the highest tax bracket in Ontario. Now, if Cathy were to donate the $10,000 in cash proceeds to charity, she'd save $5,041 in taxes from the donation tax credit. In this case, her net tax savings from the donation would be $3,435 ($5,041 less the taxes of $1,606 payable on the capital gain), which is 34.35 per cent of the $10,000 amount donated.

Cathy can do better than this by donating the shares directly to charity, rather than selling them and donating the cash. In this case, the capital gain will be eliminated. Under our tax law, a capital gain realized when donating publicly traded securities (mostly commonly stocks, bonds and mutual funds) is subject to a zero inclusion rate, meaning that none of the gain is taxable.

So, if Cathy donated the shares directly to charity, she'd save the $1,606 in taxes owing on the capital gain and would have net tax benefits of $5,041 instead, worth 50.41 per cent of the amount donated. The net tax benefit of donating securities rather than cash increases as the size of the capital gain on the securities grows.

Donate This Year

Cathy was thinking of waiting until 2024 to donate her ABC shares to charity. There are a couple of reasons for her to make the gift in 2023 instead. First, charities need the help now. The Giving Report, published by Canada Helps, shows that the rising cost of living and prolonged impacts from the pandemic have more Canadians (22 per cent) in need of charitable services. Yet, 31.5 per cent of charities received fewer dollars in 2022 than 2021, and the overall percentage of people who have donated to charities has dropped by five percentage points over the past 10 years.

Second, Cathy is a high-income earner and will be subject to the new Alternative Minimum Tax (AMT) rules starting Jan. 1, 2024. (The rules will apply to those with adjusted taxable income over $173,000). The AMT is a calculation that's done side-by-side with your regular tax calculation. Under the AMT calculation, certain deductions and credits are reduced, and if the amount owing under the AMT rules is higher than your regular tax calculation, you'll have to pay the AMT amount instead. The excess, or difference between the AMT and the regular tax amount, can be claimed as a tax credit over the following seven years. But there may be situations where you won't be able to benefit from this credit, in which case the AMT could be an absolute tax cost.

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Under the AMT calculation, the donation tax credit otherwise available is cut in half starting in 2024. In addition, the zero inclusion rate, which eliminates the tax on capital gains when you donate securities, will be increased to 30 per cent. This means that high-income earners like Cathy could receive significantly less benefit from a donation to charity in 2024 and later years than in 2023. (What a nonsensical change to the tax law.)

In Cathy's situation, donating her ABC shares in 2023 will provide her with net tax savings of $5,041 (see above), but under the new AMT rules, this net benefit drops to $1,980 – a full $3,061 less, or 30.61 per cent of the $10,000 amount donated, if she waits until 2024.

Donate Corporately

If you want to donate appreciated securities to charity and you own a corporation with taxable income, it could make sense to transfer your securities to your corporation first, then have your company donate the shares.

In Cathy's case, she does have a corporation with income, and pays herself regularly from the company. If she chooses to transfer her ABC shares to her corporation (on a tax-deferred basis under section 85 of our tax law, there's no tax to pay on the transfer) and then donate the ABC shares from her corporation, the net tax benefit becomes $5,793 (up from $5,041 donating personally). This is a 7.5-per-cent (of the amount donated) improvement over donating personally. By the way, corporations aren't subject to AMT, so this idea could make even more sense for high-income earners in 2024.

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