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New tax strategies for charitable giving

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Charities and tax experts alike are excited by the new opportunities made available by changes announced in the federal budget.

The move to completely eliminate capital gains tax on donations of publicly listed securities to charity — an area where many advisors still fear to tread with their clients — has launched charitable giving directly into the realm of financial planning.

For the philanthropically inclined, this new measure has direct implications for cash flow and comes with several simple strategies that will result in significant tax savings in the future.

Under the previous rules, only 25% of the capital gain on a gift of stock was treated as taxable income. After this rule was introduced in 1997, TD Economics says gifts of publicly traded securities soared from $69.1 million to $200.3 million. The share of securities as a percentage of all donations rose from 1.6% to 3.9%.

Malcolm Burrows, head of philanthropic advisory services at Scotia Private Client group and chair of government relations with the Canadian Association of Gift Planners says this measure was an exceptionally important factor in the charitable sector's growth over the last 10 years. "Giving in Canada has been growing at twice the rate of GDP for the last ten years," he says. "It's a major growth sector in society.

"One reason for this is that people are giving assets, such as stock, for the first time." Between 1995 and 2004, charitable giving increased 85%. He says during the previous 10 year period that number increased only 25%.

In his budget speech, Finance Minster Jim Flaherty said eliminating capital gains tax on donations would help to create a donations pool of about $300 million annually that can be used to support charitable causes. "I think that's a low ball figure," says Burrows. "This is a cyclical thing; it depends on market conditions. During a three year bull market, there's an opportunity to do this all of a sudden.

"I think giving in securities could be anywhere from $600 million to a $1 billion this year. I know that's going out on a limb, but I really believe that given current economic conditions, this incentive and stock market conditions, that we could be in for the perfect storm this year."

For clients who are likely giving to charity anyway, there are three strategies you can discuss that will help maximize the effectiveness of their gifts from a tax planning perspective and better integrate their objectives and interests seamlessly into your financial planning.

The 50-50

Clients holding highly appreciated shares, mutual funds or segregated funds, who are planning to give some of their cash flow to charity, can benefit from the new provision by determining which holding they would like to liquidate, donate half of that to the charity of their choice, then sell the other half and keep the proceeds for their own use. The charitable donation tax credit effectively wipes out capital gains tax due on the disposed shares.

For example, Jamie Golombek, vice-president, taxation and estate planning, at AIM Trimark Investments, says a top tax bracket client holding $100,000 in stock that they purchased for $20,000 would owe about $18,000 in taxes if they sold the shares outright. Using the scenario suggested by Burrows, the client could donate half of that amount and generate a federal charitable tax credit worth $14,474, which could then be applied to the

client's income tax bill that includes the $9,000 in taxes owed for gains on the shares the client sold.

"There are all sorts of extra tax savings that are spilling into other parts of their portfolio. People like that," says Burrows. "It's really very simple, there's nothing fancy about it, and the tax numbers are quite sweet."

Creative cash flow — donate shares, buy them back

"Even if you don't want to sell those shares because you think they have future potential, what you could do is donate those shares to charity, realize that tax savings, get your tax receipt and then buy them back on the open market," says Golombek. "There is no superficial gain rule which says you have to hold the shares for 30 days."

This opportunity put forth by Golombek in an advisor conference call earlier this week, allows clients to finance their charitable giving by using untaxed assets rather than the family's cash flow that is subject to income tax. "The gain is still a disposition, but you could certainly buy the shares back," he says. "You eliminate your capital gains tax and now you've got a stepped up adjusted cost base on the value of those repurchased shares."

Employee stock options

An interesting but little noticed provision in the budget now makes it possible for employees with "cashless exercise" stock options to donate to charity on the same tax-preferred basis.

Cashless exercise is an arrangement with the company that allows an employee to exercise their stock options without borrowing money to actually purchase the company shares. Under the arrangement the company's brokerage will buy the shares on behalf of the employee at the option price, then sell the shares back to the market and give the employee a check for the difference. The cash was then taxed as a capital gain.

The new budget provision allows the employee to donate cash proceeds from the sale to charity. "It's a rollover. There's no taxable event on the gift portion, which is very neat. It's a very little known provision," says Burrows. "Under the old rules I couldn't give cash and get the lower capital gains inclusion rate. Gifts of stock, yes, but not gifts of cash. Here you can actually give cash that's derived from the exercise of options."

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