Maximizing Your Philanthropic Gift: Effective Charitable Giving Strategies Using Your Holding Company

Canadians are a generous people. Every year thousands of Canadians support the causes they believe in by volunteering their time, attending events, and donating their property. We do so because we feel compassion towards people in need, we personally believe in or have been affected by a cause, or we simply want to give back to the community.

While savings taxes are not usually the number one motivator to make donations, there are significant tax savings associated with charitable giving. As such, charitable giving strategies should form part of a comprehensive estate and financial plan.

What to Give – Cash or Securities?

Because there are tax benefits associated with charitable giving, it is important to have a strategy that maximizes your gift and minimizes your tax liability. When you own publicly traded securities that have appreciated in value there is a tax liability on the capital gain at the time of disposition or sale of the security. Once the security is sold, 50% of the capital gain must be reported as income. Depending on the appreciation of the security, the liability may be substantial. However, if a publicly traded security instead of being sold is donated to a charity, the capital gain reported is reduced to zero. Whenever considering a charitable donation, it is wise to review all of your holdings.

Tax Benefits – Personal versus Corporate Gifts

When considering a charitable gift there are additional considerations if you have a private corporation. . The rules for charitable giving are in many ways the same and different for personal and corporate giving. When making a charitable gift personally you receive a tax credit, which reduces tax that was otherwise payable. This results in tax savings between 44 – 50 % depending on your province. When a corporation makes a charitable gift, the corporation receives a tax deduction, which reduces its income and therefore tax payable. The limit on the amount of the charitable donation that may be claimed in a given year is 75% of net income (both for an individual and a corporation). For an individual the limit in the year of death is a 100% of net income and any excess may be carried back one year. In both cases, if the credit or deduction is not used it can be carried forward for 5 years. The capital gains are also eliminated for corporate gifts of publicly traded securities making them an ideal and tax efficient source of funding for charitable gifts.

The key difference between giving personally versus through a private corporation is that private corporations have a notional account called the capital dividend account. The existence of this account creates a financial planning opportunity which can make a charitable gift through a corporation particularly attractive.

	Personal	Corporation
Tax Treatment	Tax Credit (reduces tax payable)	Tax Deduction (reduces income and therefore tax payable)
Carry Forward of Credit/ Deduction	5 years	5 years
Savings from Donation	45% of donation* (for donation over $200)	48% of donation * (assumes passive income)
Taxable Capital Gain for Gift of Securities	0%	0%
Charitable Donation Limit	75% of net income during lifetime	75% of net income during lifetime

*Average combined Federal and provincial tax rates across Canada. Actual tax rates will differ by province.

The Capital Dividend Account

In a holding company, when a security is sold, 50% of capital gain is taxable as income. The remaining 50% is not subject to tax and is credited to the capital dividend account (CDA). The CDA is a notional account which tracks the balances in a private corporation which are eligible to be flowed to a shareholder on a tax free basis. This account does not appear on the corporation's balance sheet, rather it a cumulative total which is often recorded in the notes to the financial statements. But its existence is important because it enables the shareholder to receive tax free withdrawals from the private corporation.

The capital dividend account is important when considering a charitable gift because when a charitable gift of securities with accrued gains is made by a private corporation, the CDA is credited with the non-taxable portion of the capital gain. In this case, this is 100% of the capital gain. So a donation of publicly traded securities to a private corporation will result in the entire capital gain being applied to the CDA.

The ability to make tax free distributions from the capital dividend account to the shareholder is a major advantage of a private corporation such as a holding company and a prime consideration when deciding if the source of a charitable gift should be made personally or through a corporation. The proceeds of a life insurance policy also flow through the capital dividend account and therefore are eligible to be paid to the shareholder on a tax free basis.

The Holding Company Challenge

You may own a holding company for a variety of reasons. It may have been for the purpose of creditor protection, or perhaps as part of a comprehensive retirement strategy to build an investment portfolio in the holding company and then withdraw dividends in retirement.

The challenge with a holding company is how to withdraw the most income from the company in a tax efficient manner. Currently, income from a holding company will be taxed in the range of 15 to 30%. Consider an example of a holding company with a value of $5,000,000. Assuming a 25% tax rate the company is actually only worth $3,750,000 after tax which is a substantial decrease. For a shareholder of a private corporation there are three levels of taxation:

1. The corporation pays tax on income as it is earned,
2. There is personal tax on distributions of income from the corporation to the shareholder, and
3. At the death of the shareholder the corporation is deemed to have disposed of its shares and there will be tax on the capital gain if the holding company has increased in value.

For many shareholders of holding companies, if the securities have been held for a long time, there may be significant accumulated capital gains and a potentially large tax liability if the securities are sold.

In developing a comprehensive estate plan, it is crucial to develop a plan for the holding company and its tax liability. Beneficiaries for your estate are usually friends, family, charities, and Canada Revenue Agency (CRA). An optimum estate plan will minimize CRA's share of your estate while maximizing the share that flows to your other beneficiaries.

Strategies to Maximize Your Philanthropic Gift Using Your Holding Company

Consider the example of Rick Smith. Rick is a successful small business owner who has spent a lifetime building a small manufacturing business. As part of his overall retirement and tax strategy he as been transferring the investments from his active corporation to a holding company. At the age of 50 he is financially secure and would like to donate $250,000 to charity. He has both the cash and securities available for the donation personally and in the holding company. The securities in the holding company have an adjusted cost base of $110,000.

Convinced of the benefits of donating securities in-kind and the additional tax advantage of a tax free distributions through the capital dividend account, Rick has decided the most efficient way to proceed with the donation is to make an in-kind donation through his holding company.

Holding Company Donation Strategy #1: Donate Securities

By making the donation of securities with an accumulated capital gain in-kind from the holding company the gift will create tax savings at all three levels of taxation:

1. The donation receipt will result in a deduction for the corporation and therefore a tax savings.
2. The donation creates a capital dividend balance available for tax free distribution to the shareholder based on the accumulated capital gain in the security (assuming the CDA has a nil balance prior)
3. The donation of the security and the distribution from the CDA reduce the value of the holding company thereby reducing capital gain at the death of the shareholder.

The results of the in-kind gift of securities are: of in-kind gift of securities:

- Immediate $250,000 gift via the holding company,
- Elimination of the capital gain on the disposition of the securities,
- Immediate addition to the capital dividend account balance of $140,000 which the holding company may be able to distribute as a tax free dividend to Rick,
- Reduced tax liability at death as the value of the holding company will be less due to withdrawal of $390,000 (donation and CDA dividend)

Holding Company Donation Strategy #2: Donate Securities and Add Insurance

By donating the securities in-kind from the holding company Rick will have corporate tax savings. Assuming Rick does not have a need for these funds, an effective strategy may be to use the tax savings to replenish the estate with the purchase of life insurance.

Assume the corporate tax savings from the donation are approximately $120,000. This could be used to purchase an insurance policy with an initial death benefit of $250,000 and a death benefit of $ 849,280 at age 85.
(Male, age 50, non smoker, standard health assumed , illustrated Canada Life Estate achiever Pay to Age 100 Whole Life, assumes $120,000 tax savings/10 years using 5% discount rate= $14,801 total premium paid for 10 years, initial death benefit =$250,000 internal rate of return 5.8% after tax

By making the donation of securities with an accrued capital gain from the holding company and utilizing the tax savings to purchase life insurance, the gift will create tax savings immediately and at Rick's death. The tax savings at death may be assed onto his children through his estate or may be used to make another charitable gift.

Result of in-kind gift of securities and insurance:

- Immediate $250,000 gift via the holding company.
- Elimination of the capital gain on the donation of securities.
- Immediate addition to the CDA of $140,000 which the holding company may be able to distribute as a tax free dividend to Rick.
- Future capital dividend account balance of $849,280 from life insurance proceeds which the holding company may be able to distribute as a tax free dividend to Rick's heirs,
- Reduced tax liability for the estate as the capital gain on the holding company shares is reduced as a result of disbursing $390,000 of the holding company's assets during Rick's life time.

By utilizing an in-kind donation through the holding company and the purchase of a corporate life insurance policy Rick has increased his gift from $250,000 to almost $1 million dollars and achieved substantial tax savings.

Holdco Donation Cost Comparison

	Sell Shares and Donate Proceeds	Corporate Donation of Securities	Corporate Donation of Securities + Life Insurance
Donation	$250,000	$250,000	$250,000
Net Cost of Gift	$111,040	$69,250	$8,284
Cost per Dollar	$0.44	$0.28	$0.03

*assumes average combed Federal and provincial tax rates across Canada of 45%. Actual tax rates will differ in each province.

The cost of making a charitable donation if structured as a corporate gift is very low. In this example it is 3 cents on each dollar donated.

In terms of the tax free capital dividend the assumption has been made that it has been spent by the shareholder or the estate beneficiaries. If in fact this money is not needed this will create another pool of capital which may be used to make further charitable gifts, ultimately the gift that keeps on giving.

The Private Giving Foundation Can Help You Leave a Lasting Legacy

Now that you can see how tax efficient it can be to make charitable gifts through your holding company, consider establishing a legacy of giving by establishing a foundation of your own. Your own foundation will receive donations from you, issue you donation receipts, and will make distributions to the charities of your choice annually. A foundation allows you to build a legacy of giving. TD Waterhouse has created a simple and effective way to establish a legacy of giving through the Private Giving Foundation, (PGF) an independent public charity.

The PGF is registered as a public foundation and allows you to enjoy many of the same benefits as a private foundation without the work and the costs normally associated with setting one up.

For philanthropists who want to make a difference, the PGF provides many advantages. It enables you to

- Simplify your giving by making donations to one foundation
- Establish a legacy of giving by including your heirs in the process
- Eliminate year-end pressure to select charities to support
- Recognize loved ones by naming the gifts from the PGF accordingly
- Provide tax-free growth of your endowment
- Provide regular reporting, tax filing and all administrative services

Four more information, please visit www.tdwaterhouse.ca/privategiving

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