TD Bank Financial Group

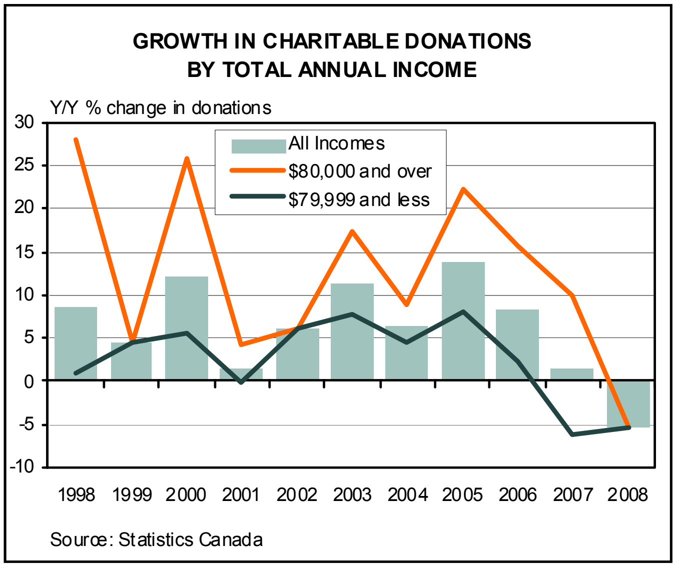
TD Economics

Special Report

May 10, 2010

WIN-WIN STRATEGIES FOR RETIREES AND CHARITIES

Canada's charities are under enormous pressure. During the recent recession, demand for charitable services increased, but donations outright contracted. Indeed, the trend in donations has been discouraging. In 2006 and 2007, a period characterized by solid economic growth, extremely low unemployment and good financial market returns, donation growth slowed to a low single digit pace. Then, the financial turmoil and subsequent recession led to a 5% contraction in donations. The added demand for charitable support by those most unfortunate during the economic downturn and the loss of donations have created a powerful financial squeeze. Looking ahead, the challenge is likely to persist. The need for help from charities will wane only slowly and financial support from governments might diminish as deficit-fighting efforts are implemented. Consequently, it is more important now than ever that Canadians help charities to weather the storm.



HIGHLIGHTS

- **Charities need donations now more than ever. The recent recession increased demand for charitable services, while the recession and turmoil in financial markets reduced donations.**
- **Charitable giving should be a key part of long-term financial planning and tax minimization strategies.**
- **Mandatory income withdrawals from RRIFs provide baby boomers with an opportunity to give and reduce their tax burden.**
- **Tax impact could be significant, as population turning age 71 expected to almost double by 2020; total pool of RRSP assets could exceed $1.8 trillion**

Charitable giving as part of tax planning

Taking an investor approach to charitable giving is one of the themes that we have written about many times in the past. Philanthropy is a noble action, but it doesn't have to be done in a purely altruistic manner. The goal should be to maximize one's giving at the same time as taking the maximum advantage of the tax system.

After the first $200 of donations, the Government of Canada provides a federal tax credit of 29% on charitable donations to encourage support of charities. You can donate up to 75% of your annual net income and you can carry forward any donations that are not claimed in the current year over any of the next five years. The provincial governments also provide tax credits, which means that donations receive federal and provincial tax credits equal to, or in many cases in excess of, the personal mar-

IMPACT OF CHARITABLE DONATIONS ON RIF PAYMENT WITHDRAWAL	Quebec	Ontario	Alberta	B.C.
Taxable Income	$150,000	$150,000	$150,000	$150,000
RIF payment*	$ 10,000	$ 10,000	$ 10,000	$ 10,000
Marginal Tax Rate	48.22%	46.41%	39.00%	43.70%
Tax payable on RRIF payment	**$ 4,822**	**$ 4,641**	**$ 3,900**	**$ 4,370**
Donation = RRIF payment	$ 10,000	$ 10,000	$ 10,000	$ 10,000
Marginal tax credit rate	48.22%	46.41%	50.00%	43.70%
Tax savings from donation **	$ 4,822	$ 4,641	$ 5,000	$ 4,370
Tax payable on RRIF payment after donation	**0**	**0**	**-1,100**	**0**

* assumes no withholding tax
** assumes this in addition to $200 of other donations
Source: TD Wealth Management

ginal tax rate. In Ontario, for example, an individual in the top marginal tax bracket will receive a credit of 46 cents for every dollar donated after the first $200.

RRSP to RRIF conversion provides an example

Many Canadians are very familiar with the tax credits on charitable giving, but there is less appreciation on how charitable giving can be used actively to address life events. One example that we have discussed in the past is the use of donations of securities to help offset the tax impact of realizing capital gains on investments. We would like to highlight another example for baby boomers, which is how charitable giving can be used to address the tax implications from the mandatory income withdrawals from registered retirement income funds (RRIFs).

Registered retirement saving plans (RRSP) have been hugely popular. The RRSP is an investment account that allows contributions to be deducted against taxable income, while capital gains or income generated in the account are tax deferred. Taxes must be paid on withdrawals from RRSPs. However, RRSPs don't last indefinitely, so the tax man must be ultimately paid. By December 31 of the year that you turn age 71, the RRSP must be rolled into a RRIF (the transfer may be in-kind). Each following year, a mandatory income withdrawal is required from the RRIF that is taxed at the owner's marginal tax rate. In the year that you turn age 71, the minimum percentage withdrawal starts at 7.38% and steadily escalates in each subsequent year.

Many baby boomers will need the income from their RRIFs for living expenses; but, for some that have significant other income sources the funds from the mandatory withdrawal are not needed. In the case of the latter, charitable donations can offset or reduce the tax hit.

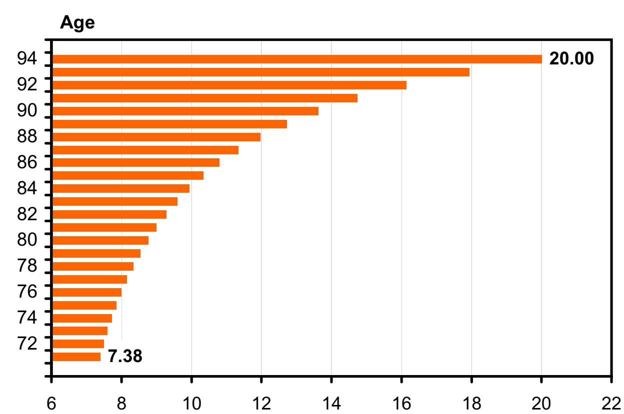
An example is useful. Nicole, age 70, lives comfortably in Ontario drawing $150,000 per annum from a variety of sources, not including any funds from her well-managed RRSP. In her 71st year, Nicole's RRSP is converted into a RRIF. In her 72nd year, 7.38% of the funds in her RRIF are withdrawn. Let's say that the RIF starts with a value of $135,501, so the first year of mandatory withdrawal is a nice round figure of $10,000. Since Nicole is in the top marginal tax bracket of 46.4%, she will owe the government $4,640 in taxes on the RRIF funds.

Nicole is philanthropically inclined and she is living comfortably on her regular income. She is also thinking well ahead and plans to make gifts from her estate when she passes away. Rather than waiting until her final years, or upon her death, to make donations to her favorite charities, she elects to start giving immediately. By donating an amount equal to her RRIF withdrawal, Nicole receives a charitable tax credit at a rate of 46.4%, precisely what she would have had to pay in taxes. Had Nicole lived in Alberta, the story would have been even better because the charitable tax credits are higher than personal marginal tax rate (see example).

Impact could be significant

If baby boomers were to embrace this approach to giving, it would be a significant boon to charities. We esti-

MINIMUM RIF WITHDRAWAL PERCENTAGES FOR SELECTED AGE LEVELS*



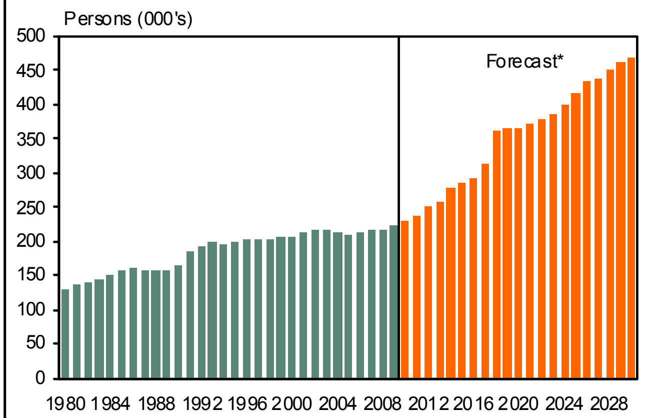
*RIFs opened after January 1, 1993
Source: TD Asset Managment

mate that even with the financial market correction, there might have been $631 billion in RRSP assets in 2008. Using a financial return assumption of 5.75% per annum, and a conservative net contribution assumption, the total pool of RRSP assets could reach over $1.8 trillion by 2020.

The bulk of the holdings will be with baby boomers in the highest tax brackets. In recent years, roughly two-thirds of all RRSP contributions were made by Canadians with annual incomes greater than $60,000. And, there has been a sharp increase in contribution rates this decade amongst those with annual incomes above $80,000.

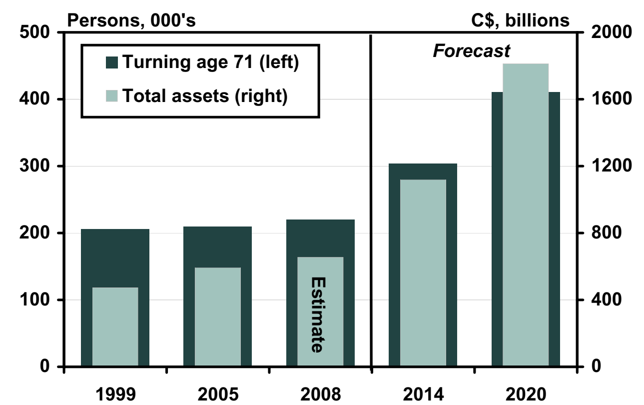
The aging population also reveals that more and more Canadians will be forced to roll RRSPs into RRIFs in the coming years. Around 217,000 Canadians turn age 71 each year at the moment, but by 2020 this number will have almost doubled to 411,000 annually.

NUMBER OF CANADIANS TURNING AGE 71



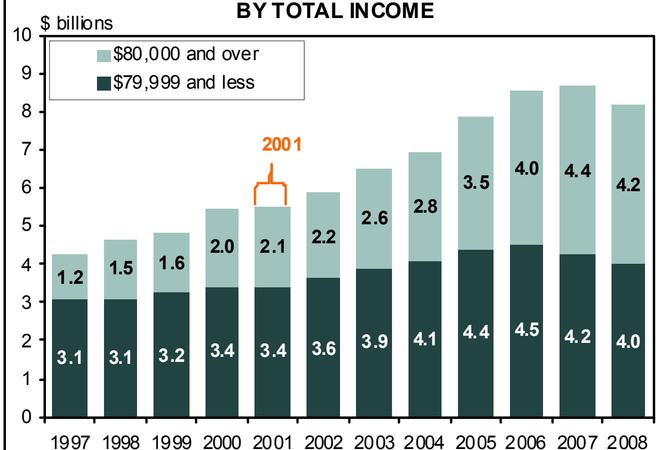
*Projections from Statistics Canada under medium growth and migration trends; Source: Statistics Canada.

PROJECTED RSP HOLDINGS*



*1999, 2005 figures from 2005 Survey of Financial Security Data
Forecast and estimate by TD Economics as at Nov 2008
Source: Statistics Canada / IFIC

CANADIAN CHARITABLE DONATIONS BY TOTAL INCOME



Source: Statistics Canada

Conclusions

Philanthropy has become more fashionable in recent years. A greater number of donors shifted from simply bequeathing funds to becoming 'venture philanthropists.' This group actively tackles challenging social issues with the same zeal that made them successful in their own right. High profile and wealthy individuals like Bill Gates, U2's Bono and Warren Buffet have been leading the charge. But, you don't have to be ultra-rich to give. Many Canadians are inclined to be generous and have the financial capacity to do so. However, too often donations are left to be made through the estate or in the final years of life. This can often mean that tax credits are lost. For example, the donations could exceed the government limits that are tied to annual income. A superior approach is to incorporate charitable giving into your ongoing financial plan. The tax system provides generous incentives for giving and the incentives are there to be used. Canadians are encouraged to talk to their financial advisers about how charitable giving and tax minimization can complement one another. And, if the donations can be found in the near term, it would surely be appreciated by charities that are facing challenging times.

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