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Tax Treatment of Charitable Giving – A Brief Overview and Recent Changes

The nature of a donation in its purest form is straightforward: the generous donor gifting property to a grateful recipient who in turn uses the property for a charitable purpose. However, the tax provisions surrounding charitable donations are anything but straightforward. The following discussion is a primer which may not cover niche rules that apply to numerous potential charitable donation scenarios. Seeking the guidance of a knowledgeable tax professional is the best way of navigating the complexities of charitable gifting.

Federal Tax Credit for Donations

The non-refundable federal charitable donation tax credit provides a deduction from an individual's taxes payable for a charitable donation(s) to a qualified donee. The Canada Revenue Agency (CRA) maintains an online list of qualified donees which includes all registered charities (among other types of entities). The first \$200 in donations is eligible for a 15% tax credit and the amount by which the total donations exceed \$200 is eligible for a 29% tax credit. However, a 33% credit

applies to individuals with taxable income exceeding \$200,000—see "Tax Computation for High Income Earners" below. A similar provincial/territorial credit is also available with respect to the donation. For example, an individual donor who resides in Ontario will receive a provincial tax credit of 5.05% on the first \$200 of donations to a qualified donee and a credit of 11.16% for the amount by which his or her donations exceed \$200.

An individual may claim donations for up to 75% of his or her net income for that year. Since the credit is non-refundable, an individual can only reduce his or her taxes payable to zero, and therefore cannot receive a further cash refund from the government as a result. Any gifts that are unused as a result of the 75% limit, or where there are no additional taxes to reduce, can be carried forward for the next five years (ecological gifts can be carried forward for ten years). Also note that the donation room will further increase by 25% of any taxable capital gains (1/2 of the gain) resulting from donating capital property in-kind. Different net income limits and carryforward rules apply for gifts resulting from death (see below).

First-Time Donor's Super Credit

If an individual and his or her spouse or common-law partner have not claimed a charitable donation tax credit in 2008 or any subsequent year, either one of them is eligible to claim the first-time donor's super credit. It provides an additional non-refundable credit of 25% on up to \$1,000 of monetary gifts (no in-kind gifts of property qualify) made by the individual to a qualified donee. Taxpayers can claim this credit for only one of the taxation years from 2013 to 2017; this credit is no longer available after 2017.

Keep Donation Receipts

An individual cannot claim the charitable donation tax credit unless he or she has been issued an official charitable donation receipt from the qualified donee. The CRA may disallow a taxpayer's donation claim because he or she was unable to produce a receipt for a donation that did in fact occur. Therefore, keeping these receipts secure and available is important, especially when it comes to claiming large donations.

Capital Gains and Charitable Donations

If an individual makes an in-kind donation of certain types of capital property to a qualified donee, his or her taxable capital gain with respect to that disposition will be zero. These types of property include (but are not limited to):

- units of mutual fund trusts and shares of mutual fund corporations;
- shares or debt obligations that are listed on a designated stock exchange;
- interest in segregated funds; or
- ecologically sensitive land.

Donations and Death

Donors who died before 2016 have enhanced flexibility compared to those making donations during their lifetimes. Donations made in the year of death (which includes donations in the will and beneficiary designations on registered

plans or life insurance policies) plus any unclaimed gifts from the five prior years are eligible for the donation tax credit. However, the amount claimed cannot exceed 100% of net income for that year. Any excess can be carried back to the previous taxation year and is again subject to the 100% net income limitation.

Recent Charitable Donation Tax Changes

Amendments to Death Donation Rules

Applicable to individuals who die after 2015, gifts made by will (or beneficiary designation) or by the individual's estate are given further flexibility. Provided that the individual's estate is a graduated rate estate (GRE), the executor has the option of claiming the credit on the following tax returns:

- the deceased's tax return for the year of the death or the return for the previous tax year (subject to the 100% of net income limit); or
- the estate's tax return for the year that the donation occurs, a previous tax year of the estate, or any of the five following tax years of the estate (subject to a 75% net income limitation).

Since a GRE may only exist for the first 36 months following the individual's death, the donation must generally be made by the estate within 36 months in order to utilize this flexibility. Recognizing that this window may be too narrow for complex estates, the government recently released draft legislation which proposed to extend this deadline to 60 months following the individual's death.

Donations to Foreign Foundations

A qualified donee includes a foreign charity which has received a gift from the Canadian government and is registered with the CRA. Until recently, only foreign charitable organizations that carried on their own charitable activities met this qualification. Effective June 23, 2015, foreign foundations (which

do not have their own direct charitable operations) may also be qualified donees if they have received a gift from Canada and are registered with the CRA. The CRA's complete list of qualified donees (including foreign charities) is available at www.cra-arc.gc.ca/chrts-gvng/qlfd-dns/qd-lstngs/menu-eng.html.

Tax Credit Computation for High Income Earners

In unison with the proposal to increase the highest federal personal tax rate to 33% for incomes exceeding \$200,000, a change to the computation of the charitable donation tax credit has been proposed. Currently, donations in excess of \$200 are eligible for a non-refundable 29% credit. If the proposals are enacted, charitable donations in 2016 and subsequent years will be eligible for a 33% non-refundable credit to the extent that an individual's income exceeds \$200,000. For example, if an individual has taxable income of \$230,000 and donates \$40,000, his or her donation tax credit will be computed as follows:

$$\$200 \times 15\% = \$30$$

$$\$30,000 \times 33\% = \$9,900$$

$$\$9,800 \times 29\% = \$2,842$$

The amount that was eligible for a 29% credit is the individual's total gifts above \$200 that were not otherwise eligible for the 33% rate. Therefore, he or she would be eligible for a total non-refundable federal tax credit of \$12,772.

Beware of Gifting Schemes

According to the CRA, they have reassessed over 190,000 taxpayers who participated in gifting tax shelters and, as a result, have denied more than \$6.3 billion in donation claims. In the most general sense, a gifting tax

shelter is an arrangement where a taxpayer would receive a charitable donation receipt for an amount greater than the cost that he or she actually incurred to make the donation.

A recent example of this was an arrangement where taxpayers would buy art, which would subsequently be appraised for greater than the purchased value. Upon the donation of the art, donation receipts were issued using the inflated values. Often the taxpayers had never seen or physically owned the art. The CRA has put an end to most of these shelters by denying the entire donation tax credit. As a result, stricter rules have been introduced for the donation of art for tax purposes.

Individuals should be cautious if they are approached with arrangements where the value of the donation receipt is higher than the cost incurred to make the donation. When in doubt, individuals should seek the guidance of an independent tax professional.

Donation of Private Corporation Shares and Real Estate

New legislation was introduced last year by the last government that proposed to introduce a new capital gains exemption. The legislation died on the order paper when parliament was dissolved, however should it be re-introduced, where an individual sells shares of his or her private corporation or real estate and donates the cash proceeds from the sale, the capital gains resulting from the sale would be exempt from tax (to the extent that the sale proceeds were received in cash). Although the proposed rules are complex, business and real estate owners would benefit from the capital gains exemption when they donate cash proceeds from selling their private corporation shares or real estate to an arm's length purchaser. We'll have to see if the new government re-introduces this attractive feature.