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Giving to charity? Choose a tax-savvy method

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It is better to give than receive, especially when that giving results in tax savings.

One of the most common ways to donate money to a charity is through a will. But this approach has drawbacks.

For one thing, the tax savings is limited. In the year of one's death you can claim only up to 100 per cent of your "final" year's income in donations. That may not add up to much. Plus, by going through your estate, probate fees of as much as 1.7 per cent apply.

In addition, estates with high levels of charitable giving are sometimes challenged by family members who want a bigger share of the pie.

High-net-worth individuals should consider other methods to boost their tax savings and ensure family harmony.

SET UP A FOUNDATION

This option may appeal to those who plan to donate more than $1-million, as it allows the donor to have greater control over how dollars are given.

The foundation manages the money for you; it can earn income by investing the capital while donating to causes of your choice, even after you're gone. It can also allow your name or your family's name to be associated in the long term with what's important to you.

"The intention of a foundation is to create a lasting legacy that earns a return and allocates funds to charities annually," says Jennifer Reid, vice-president of tax and estate planning at Richardson GMP in Calgary.

USE LIFE INSURANCE

Donors can designate a charity as the beneficiary of a life-insurance policy. Funds are paid directly to the charitable organization, avoiding any potential estate battles. Since the funds don't form part of the estate, they avoid probate, too; probate fees vary by province but can be as high as 1.7 per cent, which can add up on a significant charitable gift.

Insurance has other advantages. If it's structured properly, the annual premiums can be considered charitable giving, meaning donors receive a tax credit each year.

"Donating life insurance is often beneficial, as an individual can determine the amount of donation credits that will be needed to offset the tax bill at death," Ms. Reid says. "They can then fund a policy that generates the required death benefit. As the charitable donation offsets the tax, the remainder of the estate is kept whole for the family beneficiaries."

Life insurance, depending on the policy-holder's health and other factors, may cost less to purchase than the actual death benefit, Ms. Reid says. "You may be able to purchase the appropriate death benefit, and therefore donation, for much less than a straight cash donation from the estate."

GIVE STOCKS

Donating stocks that have accumulated capital gains can be advantageous, as you're donating "pre-tax" dollars.

Ms. Reid shares an example: Say you want to donate $1,000. You decide to liquidate stock from your portfolio to generate the cash. If you sell stock worth $1,000, but you originally paid $500 for it, you have a capital gain of $500 (50 per cent of which is subject to tax).

In this example, you pay tax and the charity receives less than $1,000.

Rather than liquidating the stock yourself and paying the tax, you donate the stock. The charity receives the shares, worth $1,000, and issues a donation receipt for $1,000. It can then turn around and sell the stock.

"The charity gets more, the individual gets a higher donation receipt and is exempt from paying tax on the capital gain that would otherwise result from selling or disposing of the shares," Ms. Reid explains.

SET UP A TRUST

Whereas a foundation is set up for a particular charitable, non-profit or other social or religious purpose, donations can be made through a trust as well. A trust can be set up in one's lifetime (inter-vivos trust) or upon death (testamentary trust).

Designated trustees then distribute capital or income up to the maximum federal or provincial tax credits available, the advantage being they can control the timing of the donations and whether they are lump sums or part of an income stream.

The benefits of using a trust can change with the times, however. “Sometimes the government is generous with a lot of tax credits for charitable giving; some years, depending on who’s in power, they restrict or limit the amount of tax credits,” says Henry Villanueva, legal counsel at Calgary’s MacMillan Estate Planning Corp. He recommends consulting an accountant and lawyer.

DONATE RRSPS AND RRIFS

You can designate a charity as a full or partial beneficiary of your registered retirement savings plan (RRSP) or registered retirement income fund (RRIF).

Generally, the largest tax hit on an estate is for the remaining balance of an RRSP or RRIF on the death of a second spouse, because the Canada Revenue Agency treats this as income in the year of death. This money can be taxed at more than 50 per cent, including probate fees. A donation would cancel out this tax.

USE DONOR-ADVISED FUNDS

This method is similar to a foundation – you can leave a legacy, earn income and donate to worthwhile organizations over time – but without the operating expenses and administrative work, such as establishing and maintaining a board of directors, Ms. Reid says.

With donor-advised funds, people typically make a lump-sum contribution and receive a tax-credit receipt; the money is then managed inside the fund and given to causes according to your wishes.

The administration of the fund is completed for a fee by a partner organization, says Ms. Reid. Her firm uses Benefaction Foundation, which specializes in managing charitable giving for high-net-worth Canadians.

“A private foundation is more public – the Smith Family Foundation, for example – whereas a donor-advised fund is private,” Ms. Reid says.

Donor-advised funds are also a great way to involve children and grandchildren in the effort. “It can help to teach not-so-financially-savvy individuals the value of a dollar and the value of supporting valid charitable causes.”