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TAXSTRATEGY

With proper planning, your generosity will help you…

Give and receive

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Creating a charitable legacy can be one of the most personal and enduring decisions you will ever make.

And by using a new or existing life insurance policy, you can extend your philanthropic footprint while reducing your taxes now, or later for your estate. In other words, you can both give and receive.

It's interesting to note that without proper planning, you might inadvertently make Canada Revenue Agency (CRA) one of your beneficiaries. As it now stands, Ottawa collects:

☞ $460,000 per $1 million of your retirement savings, meaning 46 per cent of your retirement savings will be taxed after the death of both spouses;

☞ $320,000 per $1 million of your investment holdings, which translates into 32 per cent of your holding/operating company assets that will be paid in taxes;

☞ About $1 million per $5 million of investment growth, or 23 per cent of your accumulated capital gains from investments, real estate and business equity, will be paid as taxes after the death of both spouses.

But there is a better way: charitable planned giving, constructed to give you the most tax-efficient outcome while providing your charitable organization with a more substantial gift.

Of course, there are a number of reasons why you might want to donate to a charity in the first place.

It could be to honour or continue the work of a loved one, or help eradicate an illness that has affected a family member or friend. Perhaps it's to pay forward a good turn someone has done for you or your family.

Charitable planned giving

Then there is the case of Dr. Jonathan Bishinsky, an internist practicing in heart diseases, who consults in the cardiology department at Mackenzie Health Richmond Hill Hospital. He also happens to be a client.

After a thorough review of his insurance portfolio, we concluded the good doctor actually had too much insurance. But rather than cancelling the surplus, I suggested he gift that "extra" policy to charity. He liked the idea, and donated the insurance to four worthy causes, including the Southlake Regional Health Centre in Newmarket, Ont., and the Jewish Foundation of Greater Toronto.

All recipients were delighted to receive the "future gift" bequest. Dr. Bishinsky could have given to any hospital, or any charity for that matter, but he opted for Southlake as a way of giving back to the community in which he works.

There are many people just like Dr. Bishinsky with the means and opportunity to make life better for those less fortunate.

And with professional advice and planning you can ensure that your intentions are

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satisfied, while taking advantage of tax-saving incentives offered by the government.

A better tax break

On top of the philanthropic reasons for giving, using a life insurance policy as a future gift leaves funds free to produce income during your lifetime.

While no two cases are identical, following this method generally means you will also receive a better income-tax break than if you donated annually.

As for the charity, it benefits when you use a life insurance policy because the proceeds of the policy are usually many times more than the value of the premiums.

The charity also generally receives a larger gift than if you had donated cash. Life insurance policies also typically avoid or reduce estate taxes and, with a designated beneficiary, the money flows immediately to the charity with no hassle.

Many options are available when considering planned charitable giving. Any of them will let you create a legacy that provides for future generations, while making sure you and your loved ones are able to reap significant benefits and rewards.

Still, there are two main avenues for using your life insurance policy to provide a tax-efficient avenue for charitable giving.

The first route is to buy the policy and name the charity as beneficiary. By ensuring that the charity has a charitable registration number, the premiums you pay for the policy qualify as a tax deduction on your yearly income tax return.

You can also transfer ownership of the policy and the beneficiary designation of an existing policy to the charity. This way, you can claim the charitable donation credit for any premiums you pay after the transfer takes place.

The second way is to purchase a new life insurance policy and name either the charity or your estate as the beneficiary and include the charity as part of your will. If you want, you can change the name of the charity that will receive the benefit down the road.

You can't get a charitable donation credit for any premiums, but the charity can issue a tax receipt for the proceeds it receives for your final tax return. This will potentially save your estate quite a few dollars.

For example, somebody with a $1 million tax liability could leave $2 million in insurance proceeds, therefore erasing the bill owing to CRA. They can now be remembered for leaving $2 million to charity instead of $1 million to the tax department.

You also have the option of creating a charitable gift annuity, which will provide you with a guaranteed income for life and a tax receipt for the gift portion of the annuity. This may be especially attractive to more conservative investors.

And if you have the means, there are other ways to ensure your generosity for the years ahead.

For example, if you have no surviving spouse (or have made other estate planning arrangements), consider making a charity the beneficiary of your RSP or RIF. Instead of 46 per cent being siphoned off for the tax department, the entire contribution will help your worthy cause – and the tax department will get none.

Other strategies include supporting charitable giving through an endowment, which entails providing an irrevocable gift to either a private foundation or what's known as a donor-advised fund (DAF) within a public foundation.

An endowment is best for those who want to ensure a sustainable legacy in which your family can be involved, rather than a one-time gift.

Under CRA rules, the endowment must grant a minimum of 3.5 per cent of its asset value every year. This is great news for your charity or charities, which can count on the income from the underlying capital coming in annually.

A major tax advantage for private endowments and DAFs is that donors can receive full tax benefits for contributing without having to disburse the entire contribution amount immediately.

A private foundation can be set up either as a trust or a corporation. Under the trust structure, there are fewer audits and no requirement for an elected board of directors or annual general meetings. Private foundations generally prefer incorporation to give them the direct involvement they want in their charitable activities.

What's the difference between a private endowment and a DAF?

DAFs only take 24 hours to set up and are more turnkey than a private foundation. Their quick implementation often results in DAFs being created around the end of the year to take advantage of the annual tax deadlines.

DAFs are also part of a larger public foundation, and any tax reporting and record-keeping is provided for the donor as part of the overall fee that is charged.

Private foundations, on the other hand, typically take three months to establish.

These are organizations set up exclusively for charitable purposes. Rather than funding its ongoing operations through periodic donations, a private foundation generates income by investing its initial donation, often disbursing the bulk of its investment income each year to charities.

Because they report to CRA, private foundations must maintain their own record-keeping and reporting and pay for administrative and legal expenses. Set-up costs are the responsibility of the foundation.

There are many ways to dedicate a portion of your wealth to charity. By incorporating a life insurance policy with charitable donations into a comprehensive estate plan, your assets can benefit causes you care about – and do so in a tax-efficient manner.

With proper planning, your generosity will go far and the organizations you support will be immensely appreciative of your kindness. ❐