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The Alternative Minimum Tax (AMT)

Bad News for Canadian Philanthropy Starting in 2024

BY MARK HALPERN, CFP, TEP, MFA-P

Most Canadians still use cash, cheques and credit cards to make charitable donations. There are many better ways. One is to donate in-kind non-registered appreciated securities, such as stocks, mutual funds, exchange-traded funds (ETFs) and segregated funds. The reason this works so well is that when you give these appreciated securities to a registered charity:

1. You can deduct the donation amount, which is the fair market value of the securities.
2. You don't have to pay capital gains tax on the difference between the fair market value and the adjusted cost base.

The donation receipt can mitigate up to 75 percent of net taxable income, and the donor saves 27 percent tax on the capital gains. Because this is such an effective strategy, the largest transformational donations to charity have in recent years come through the donation of appreciated securities.

Unfortunately, a significant change proposed in the federal budget is expected to negatively affect the tax treatment of charitable donations of appreciated securities by people who pay the alternative minimum tax (AMT). These are high net worth Canadians and some of the most generous donors to our charitable sector. The AMT changes will affect both philanthropists and the charities they passionately support.

The full draft legislation hasn't been released yet. However, the new rules, scheduled to take effect on January 1, 2024, are expected to reduce the donation tax credit (and other non-refundable credits) by 50 percent and include 30 percent of capital gains on donations of publicly traded securities in the calculation of AMT. In addition, 100 percent of capital gains (up from 80 percent) and qualifying stock options (up from 50 percent) will be added to the AMT income base. Just 50 percent of many expenses — such as interest expense and capital and non-capital loss carryforward balances — will be deductible from the AMT income base. At the same time, the flat AMT tax rate will increase to 20.5 percent from 15.0 percent above an exemption amount that is being raised to $173,000 from $40,000.

AMT changes will affect charitable giving

Hemal Balsara, Manulife's Head of Tax, Retirement and Estate Planning, believes the AMT changes will have a short-term impact and a longer-term impact on philanthropic giving. In the short term, tax advisors will encourage clients to donate before December 31, 2023, when the new rules will come into force. That may produce a bump in donations this year. In the longer term, tax advisors may counsel clients to adjust their donation amounts to avoid AMT.

Alexandra (Ali) Spinner, Tax Partner with Crowe Soberman LLP, says that while donors affected by the legislation may still make the same total amount of donations in their lifetime, the AMT changes could have the effect of slowing down those donations as affluent people work with their planning teams to stay within AMT goalposts. She says, "I expect that the goalposts of AMT will become narrower … If a person could donate a certain amount in 2023, they may find that, because of the new rules, they may have to donate less in 2024 to make sure that AMT doesn't kick in."

One silver lining is that, with proper planning, AMT is what Hemal calls a "temporary tax" because it can be carried forward for seven years and applied to lower income tax in years when income tax is higher than AMT. Nonetheless, Hemal points out that high net worth individuals who make sustained large donations, year in and year out, will have a significant disincentive to continue. Note also that taxpayers who cease to be Canadian residents or who pass away during that seven-year period won't get the full benefit of the carryforward provision and may experience an absolute increase in tax.

Are there workarounds for people who pay AMT?

The easiest immediate workaround is to donate publicly listed securities with significant capital gains in 2023 rather than waiting for 2024 and future years. For people who were already thinking of making a gift to a worthy cause, there's no time like the present. Ali points out that donors who are fulfilling a pledge to a charity and who don't want to hand over a very large donation in 2023 can donate to a donor advised fund in 2023, receive the tax receipt, and then slowly turn the tap on the release of the funds to the charity over the coming years.

Generous donors who are looking for even more impact can consider using those donated securities to fund a one-payment-only life insurance policy owned by their donor advised fund, charity or private foundation that can also create an annual cash flow for charity. Canada Life recently launched a one pay insurance policy for charitable giving that does just that. It's called My Par Gift™ and it's worth looking into.

When we get to 2024, depending on the final wording of the legislation, one potential workaround for people who hold assets within a corporation is to donate publicly traded securities from the corporation rather than individually held assets. As Hemal says, "What's also good about donating marketable securities through a corporation, regardless of whether you have AMT or not, is the fact that 100 percent of the capital gain gets added back to your capital dividend account (CDA). So now it allows you the opportunity to strip out monies from your corporation — and the CDA is not subject to AMT."

Unfortunately, the federal government's efforts to increase tax revenues from affluent people who are paying low rates of tax will restrict tax planning. Strategies to reduce income tax will increase AMT — and when AMT exceeds income tax, that's the cheque you have to cut to the government. Tax advisors will need to do a two-pronged calculation, and philanthropists will need to weigh their desire to be benevolent against a potentially punitive tax bill.

Speaking up on behalf of charities

Much of my work involves helping families to incorporate strategic philanthropy into their estate planning while creating enduring family legacies for generations to come. We also work with 60 Canadian charities, large and small, in the areas of fundraising and legacy planned giving. I've advised many, many clients on donating publicly traded securities to worthy causes, including local hospitals, universities, museums, and performing arts, environment, and social welfare organizations.

I've written to Finance Minister Chrystia Freeland to express my concerns about the negative impact the AMT changes will have on donations to charities, asking her directly if her government intentionally or unintentionally took steps to reduce the level of charitable donations through gifts of publicly listed securities. Because I believe that imposing AMT on donations of public shares will have a significant effect on fundraising across Canada, I've urged her to seek further input from charities and financial advisors before making these new rules into law.

I will continue to advocate for charities on this and other issues, and I encourage other professionals who work in this space to speak up as well. Our charities do so much good work, positively affecting the lives of so many Canadians. They deserve a tax regime that supports them — like the 25 pieces of legislation passed since 1995 that make it easier for Canadians to donate — rather than one with potential to cut off a significant source of their funding.

Meanwhile, I see an opportunity for all affluent Canadians and business owners to respond to all the chatter about AMT by redoubling their efforts to incorporate strategic philanthropy into their planning in ways that make the most sense for their charitable goals and financial situation.

Setting AMT aside for a moment, it's possible to transform a $50 million estate with a $10 million tax bill and no charity into a $50 million bequest to family with a $20 million gift to charity that erases the $10 million tax bill using life insurance. This can be set up for pennies on the dollar or, in some cases, on a cash-flow neutral basis. The key is to put the right team of professional tax, legal, investment and insurance experts in place and get them collaborating to achieve your unique goals. We need to work together to make it happen!

So please don't hesitate to contact us for a no-obligation conversation. Introduce us to your situation and allow us to share estate planning, tax minimization and philanthropy strategies to help you achieve your unique objectives.

MARK HALPERN is a well-known CFP, TEP, MFA-P (Certified Financial Planner, Trust & Estate Practitioner, Master Financial Advisor – Philanthropy). He was honoured to speak in the Disruptors Category at Moses Znaimer's most recent ideacity conference. His talk generated high interest and comments. Watch "The New Philanthropy" at bit.ly/MarkHalpernTalk. Learn more at www.wealthinsurance.com. He writes this column exclusively for each issue of *Foundation Magazine*.

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