| Benefaction Charitable Public Foundation

Donor advised funds, endowment funds, gift planning, planned giving, donating gifts of securties

Case Study: Disinherit the taxman – a 50/50 strategy

Nicola Elkins · Monday, June 6th, 2011

Disinherit the taxman with a 50/50 charitable strategy

Reproduced with permission by the author; Keith Thomson, CFP, CIM is a managing director of Stonegate Private Counsel, a division of CI Private Counsel LP.

There is a belief that making a significant gift to charity means disinheriting your family and friends, sometimes referred to as “zero sum estate planning.” But nothing could be further from the truth. Including charitable giving in the planning process can be like adopting another child while disinheriting the tax man. The good news is the government agrees, having legislated what some would argue is one of the most advantageous tax environments to encourage charitable giving.

Meet the Wilson’s

Here is one scenario. Ken and Doris Wilson are retired, aged 70 and 68, and charitable. They have three children and 10 grandchildren. Before introducing them to the many voluntary philanthropic planning techniques, it is crucial to bring clarity to the Wilsons’ financial situation. Specifically, the question of whether they have enough money must be answered conclusively.

Using financial planning software, it is possible to determine the approximate dollar amount in assets needed to generate an inflation adjusted income that the Wilsons could never outlive. Only by zeroing in on this number is it possible to address the question of how much they would like to leave their family. Once this is taken care of, they can engage in a discussion about their social capital legacy. In other words, those dollars that would have gone to tax now, instead, can be redirected to their favourite charities.

Assuming we have clarity with regard to the Wilsons' financial situation, it is now possible to introduce them to the many financial planning techniques that could leverage their social capital and bring emotional significance to their lives. For example, assume that a number of years ago they invested in an obscure company with a great technology. Today their Research in Motion (RIM) stock is valued at $100,000 with an adjusted cost base of $20,000.

The Wilsons are reluctant to sell, as would many individuals whose embedded capital gain is $80,000. They find themselves in the highest tax bracket and selling their RIM position would result in a capital gains tax of approximately $20,000. (This is based on a hypothetical situation, used for illustrative purposes only and is not meant to be treated as personal financial planning advice. The numbers used are rounded for ease of illustration.)

Fortunately, the Wilsons are philanthropically inclined and have also expressed the following objectives:

- minimize taxation whenever possible;
- convert a percentage of their growth assets to income generating vehicles;
- and leave as much as possible of their estate to family and friends.

It is possible to achieve all their objectives with a 50/50 strategy.

The first step entails selling 50% of their $100,000 RIM stock for personal use. The sale will leave them with $40,000 after paying $10,000 in capital gains taxes.

The second step is for the Wilsons to donate the remaining $50,000 of their RIM stock to their favourite charity. This will result in a $25,000 charitable tax credit being made available to them. As this is an in-kind stock gift to a registered charity, there is no capital gains tax to pay. Eliminating the capital gains tax on appreciated stock is another example of how our government encourages Canadians to give to charity. With part of this $25,000 tax credit the Wilsons are effectively eliminating the $10,000 in capital gains tax on the outright $50,000 sale of their stock, and they still have $15,000 of the tax credit remaining.

In the third step, with the full $50,000 now available from the proceeds of the RIM sale, the Wilsons can invest in a second-to-die life annuity, which will provide them with a $3,400-a-year income stream for the rest of their lives. This represents close to a 7% guaranteed return on their $50,000 investment.

So far, so good; but what about the Wilsons' family?

Hasn't it been disinherited of $100,000 with the sale and gift of the RIM stock? This is a touchy subject for many families, as it is generally thought that making any kind of gift to charity effectively negates those dollars that otherwise would go to family members.

Fortunately, there is a simple solution. The Wilsons still have a $15,000 tax credit left over from the outright gift of $50,000 of their RIM stock. Assuming their insurability, this charitable tax credit can now provide the funds to invest in a fully paid up second-to-die insurance policy that will pay out about $100,000 to their estate on a tax-free basis.

Let's revisit the objectives the Wilsons wished to accomplish.

• Minimize taxation whenever possible. By donating $50,000 of their RIM stock they are completely eliminating the capital gains tax payable to the Canada Revenue Agency. At the same time they now have in their possession a $50,000 charitable receipt issued by their favourite not for profit.

• Convert a percentage of their growth assets to income generating vehicles. By investing $50,000 of their RIM proceeds into an annuity, the Wilsons are able to generate a $3,400-a-year income stream (an approximate 7% return), fully guaranteed for the rest of their lives.

• Leave as much as possible of their estate to family and friends. This is done by taking advantage of the remaining $15,000 tax credit to purchase a fully paid up second-to-die insurance policy, resulting in their heirs receiving the full $100,000.

To sum up, the Wilsons are achieving their personal objectives, their family members will receive more money from the estate than they otherwise would have and a charity will have $50,000 to advance its mission. In the end, if done properly, effective philanthropic planning can indeed be thought of as adopting a charity while disinheriting the tax man.

This entry was posted on Monday, June 6th, 2011 at 6:00 am and is filed under Advisors Corner, Quarterly, Summer 2011
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.