| Benefaction Charitable Public Foundation

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

Case Study: Donating Flow Through Shares

Nicola Elkins · Thursday, September 9th, 2010

Case Study – Donating FTLP's

Please review the notes on the 2011 Budget changes affecting FTLP's below.

Investors who buy units of a Limited Partnerships can further improve on their tax-efficiency by donating their return. Here is how it works in more detail. The Limited Partnership takes the investments to purchases shares of small cap resource companies. By virtue of a written agreement with the Limited Partnership, the companies agree to renounce their Canadian Exploration and Canadian Development Expenses (CEE) to the Limited Partnership, which in turn flows the CEE expenses to the individual unit holders. The unit holders use these expenses as a deduction in income to reduce the value of their original investment in the Limited Partnership to nil or zero – a process that may take up to two years.

The investor can write off the capital cost of the securities against income. After a couple of years, the Limited Partnership typically rolls all of its holdings into a mutual fund and a special election is filed to eliminate any tax on this roll over. Now the mutual funds are publicly traded securities with a fair market value and when sold or gifted, the difference between their ACB and the fair market value is a capital gain.

How it works

Investment generates deduction in year of investment
2 years later, Limited Partnership converted to mutual fund

Taxpayer donates units to charity and receives tax credit

Benefits to You

FTLP's:
At the end of the day, the investor could have three tax wins.
1. The investor can write off the capital cost of the securities against income (some provinces also kick in credits that permit unit holders to realize tax savings in excess of their original investment).
2. By reducing the capital cost if the units to zero or nil, when the investor sells their units, they realize a capital gain, not regular income. Capital gains are taxed far more favorably than normal income.
3. If the securities are owned by a personal corporation;, the entire gain can be placed into the Capital Dividend Accounts (CDA) to be paid out to shareholders on a tax-free basis.

Flow-Through Shares: a simple example

On April 12, 2011, Kathleen is a high-risk investor in the 46% marginal tax bracket. She invests $10,000 in a flow through limited partnership. Over the next two years, she deducts the entire $10,000 (assume no provincial credit), which saves her $4,600 in taxes. Kathleen's Exemption Threshold is $10,000. When the limited partnership rolls her holdings (and everyone else's) into a mutual fund, there is no tax consequence to her. Her units of the mutual fund have a nil cost and a $10,000 FMV. She decides to donate them to her church. The church issues her a $10,000 tax receipt that reduces another $4,600 in taxes. No portion of the capital gain exceeds the $10,000 exemption threshold, therefore, 50% of the gain is taxable resulting in new tax of $2,300 ($10,000 X 50% X 46%). Kathleen's net tax win is $6,900 ($4,600 deduction + $2,300 net tax savings on donation).

The cost of making a $10,000 donation is only $3,100 ($10,000 – $6,900). In other words, it cost Kathleen 31 cents ($3,100/$10,000) to donate one dollar! It is important to note **THAT UNLIKE PRE-BUDGET 2011, KATHLEEN COULD HAVE SOLD THE INVESTMENT AND DONATED THE CASH FOR THE SAME TAX EFFECT.**

DONATIONS OF FLOW-THRU SHARES

An excerpt from Bulletin 245 March 2011 by Karen J. Cooper, Carters Professional Corporation

Since the elimination by the 2006 Budget of the tax on capital gains accruing on donations of publicly-traded securities to registered charities, donation tax shelter structures involving gifts of flow-thru shares ("FTS") have increased substantially. Generally, a taxpayer can acquire FTS issued by corporations in the oil and gas, mining and renewable energy fields and claim the benefit of "flow-thru" income tax deductions of certain expenses. As these deductions are claimed, the adjusted cost base ("ACB") of the shares is reduced (usually to nil) such that when the FTS are sold, the full amount of the sale proceeds are taxed as a capital gain. If, instead, the FTS are donated to charity, the taxpayer gets the benefit of a tax credit or deduction based on the value of the share at the time of the donation and can also claim the benefit of the exemption from capital gains tax on the disposition. In many circumstances, the combined effect of the deduction of the "flow-thru" expenses, the elimination of the capital gains tax, and the charitable donation deduction or credit substantially reduces or virtually eliminates the after-tax cost of making a charitable donation.

The 2011 Budget proposes to limit the availability of the exemption from tax on capital gains where FTS are donated to a qualified donee. Effective on or after the Budget date, the exemption from tax on the capital gain that arises from the donation of FTS will only apply to the extent that the cumulative capital gains in respect of the gift exceeds the original cost of the FTS. This will have the effect of substantially reducing the tax benefits of a gift of FTS so that they are generally no more attractive an option than any other gift of shares or cash. The Budget also contains anti-avoidance provisions that are intended to ensure taxpayers are not able to structure around these changes.