Wealth Management

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

Donating flow-through investments

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To encourage charitable giving, the government provides you with a tax credit when you make a donation to a registered charity. This donation tax credit can be used to reduce your taxes payable. In some cases, you may be entitled to a further benefit if you donate flow-through investments. This article discusses the tax implications of donating flow-through investments in-kind from your personal non-registered account.

Tax benefits of donating flow-through investments

When you purchase a flow-through investment and subsequently donate the investment in-kind, you may benefit from the following:

- Deduction of exploration and development expenses flowed through to you against your taxable income;
- Applicable federal mineral exploration tax credit and applicable provincial/territorial flow-through share tax credits that reduce your taxes payable;
- Donation tax receipt for the fair market value (FMV) of the donated flow-through investment; and
- A portion of the capital gain realized on the donation of the investment may be eliminated.

Capital gains on donating flow-through investments

Generally, when you gift property, the property is deemed to have been disposed of at FMV. As such, you may realize taxable capital gains if you donate property that has an adjusted cost base (ACB) that is lower than its FMV. The capital gains realized when donating publicly traded securities may be eliminated in some cases if you donate the securities in-kind.

The elimination of capital gains works differently for flow-through investments. Because the ACB of a flow-through investment is typically zero or close to zero, there would be a significant benefit if the capital gain could be eliminated on the donation of a flow-through investment.

In 2011, the federal government introduced rules to limit what they saw as excessive tax benefits. Under these rules, you may realize a deemed capital gain when you donate flow-through investments. The deemed capital gain is equal to the actual capital gain realized on the donation or your “exemption threshold,” whichever is less. In very simplified terms, your exemption threshold is equal to the original cost of all flow-through shares of the same class, less any cumulative capital gains realized on the disposition of flow-through shares in the same class. This essentially means the exemption from capital gains tax will be available only to the extent that the actual capital gain on the donation of flow-through investments is in excess of your original cost amount.

Grandfathering for certain flow-through investments

The deemed capital gains rules do not apply to flow-through common shares acquired before March 22, 2011, or shares of a mutual fund corporation that are received in exchange for flow-through limited partnership (LP) units acquired before August 16, 2011 (no contributions to the partnership can be made on or after August 16, 2011).

Generally, only the original cost of flow-through shares acquired on or after March 22, 2011, and flow-through LP units acquired on or after August 16, 2011, will be added to your exemption threshold. For example, if you only owned flow-through common shares purchased prior to March 22, 2011, your exemption threshold will remain at zero and you can donate the shares and benefit from the old rules (i.e. you will still be able to exclude your entire capital gain realized at the time of donation). Likewise, if you acquired flow-through LP units before August 16, 2011, once they are exchanged for shares of a mutual fund corporation, you can donate them and still benefit from the old rules.

When you donate a flow-through investment, in addition to getting a donation tax receipt for the FMV of the investment, some of the accrued capital gain on the investment may also be eliminated.

Example – Tax impact of donating a flow-through investment

Here's an example to illustrate the impact of the deemed capital gains rules. Say you purchased 500 flow-through shares of XYZ Co. for an original cost of $50,000 and later donated all 500 shares of XYZ Co. when they're worth $45,000. Under the grandfathering rules, the taxable capital gain would be zero.

Under the deemed capital gains rules, the exemption threshold is calculated as the original cost of $50,000.

The deemed capital gain is calculated as the lesser of:

a) the actual capital gain on the donation ($45,000); and

b) the exemption threshold ($50,000).

As a result, you realize a deemed capital gain of $45,000 on the donation.

The following table illustrates the tax implications of selling the XYZ Co. shares and donating the proceeds versus donating the shares in-kind.

	Sell and donate proceeds	Donate in-kind (grandfathering rules)	Donate in-kind (deemed capital gains rules)
Initial cost of investment **(a)**	$50,000	$50,000	$50,000
Deductions claimed	$(50,000)	$(50,000)	$(50,000)
Tax savings @ 48%* **(b)**	$24,000	$24,000	$24,000
FMV of donation	$45,000	$45,000	$45,000
Adjusted cost base	$0	$0	$0
Capital gain/deemed capital gain	$45,000	$45,000	$45,000
Taxable capital gain	$22,500	$0	$22,500
Tax on taxable capital gain @ 48% **(c)**	$10,800	$0	$10,800
Tax savings from donation tax credit **(d)** ($45,000 @ 48%)*	$21,600	$21,600	$21,600
Total cost of donation = (a) – (b) + (c) – (d)	**$15,200**	**$4,400**	**$15,200**

This illustration does not take into account the lower donation tax credit rate on the first $200 of donations.

* The above illustration uses an assumed marginal tax rate and a donation tax credit rate of 48%.

Conclusion

Making charitable donations provides individuals with a chance to give back to their community and receive tax incentives at the same time. When you donate a flow-through investment, in addition to getting a donation tax receipt for the FMV of the investment, some of the accrued capital gain on the investment may also be eliminated. Speak with a qualified tax advisor to determine whether it may make sense for you to donate flow-through investments in-kind.