

# Donating Appreciated Securities

The benefits of making a charitable donation are countless – from helping those in need to the personal satisfaction of giving back to the causes that are important to us. Charitable giving also makes good sense from a tax perspective. With proper planning, you can reduce your total income tax liability and maximize the value of your donation.

In an effort to increase charitable donations, the tax law allows for the full elimination of any capital gains tax on donations of publicly-traded securities to a registered charity.<sup>1</sup> Qualified securities include shares, debt obligations or rights listed on a designated stock exchange, and shares/units of mutual funds and exchange-traded funds (“ETFs”).

## Charitable donation tax credit

Similar to cash donations, the fair market value of property (i.e., securities) donated to a qualifying charity is reported on a charitable tax receipt, which can reduce an individual donor’s taxes through the donation tax credit. The maximum amount of all donations an individual can claim on their tax return each year is 75% of net income.<sup>2</sup> Donations that cannot be claimed in a given tax year can be carried forward for up to five years. For annual donations made after 2015 that exceed \$200, the Federal tax credit is calculated at the top 33% marginal rate, but only on the portion of donations made from income that is subject to this top marginal tax rate. For any donations made in excess of \$200 where the individual’s taxable income is less than the top tax bracket of \$246,752 (in 2024), a 29% Federal tax credit will apply, which was the previous top Federal marginal tax rate.<sup>3</sup>

## Donating securities

If you are planning to make a charitable donation this year, consider this tax saving strategy; especially if you’ve already made the decision to sell some of your current investments to provide the cash to fund this donation.

By donating securities directly to a charity, you have an opportunity to reduce the tax you would otherwise have to pay on the sale of your investments. As with any sale,

a donation of securities is considered a disposition for tax purposes. However, as a result of these tax incentives, the taxable capital gain that would otherwise be realized on a donated publicly-traded security can be eliminated. Whether you donate the cash proceeds or the security directly, you will receive a tax receipt for the full value of your donation, regardless of the tax treatment of the capital gain.

The table below illustrates how this special incentive increases the impact of a charitable donation when the property donated is a qualified security, instead of the cash proceeds from the sale of a security.

| Benefit of Donating Appreciated Securities       |                               |            |                 |          |
|--------------------------------------------------|-------------------------------|------------|-----------------|----------|
| Tax on disposition                               | Sell security and donate cash |            | Donate security |          |
| Capital gain on sale of security                 | \$50,000                      |            | \$50,000        |          |
| Taxable portion of capital gain <sup>4</sup>     | 50%                           |            | 0%              |          |
| Taxable capital gain                             | \$25,000                      |            | \$0             |          |
| Income tax payable (50%) <sup>5</sup>            |                               | (\$12,500) |                 | (\$0)    |
| Donation Tax Credit                              |                               |            |                 |          |
| Charitable donation amount                       | \$50,000                      |            | \$50,000        |          |
| Add tax savings from donation (50%) <sup>6</sup> |                               | \$25,000   |                 | \$25,000 |
| Net tax savings                                  |                               | \$12,500   |                 | \$25,000 |
| Net cost to donate \$50,000                      |                               | \$37,500   |                 | \$25,000 |

The example assumes an individual owns a security with a current value of \$50,000, and a nil tax cost base. It further assumes that the capital gain realized on the sale is \$50,000, and the entire \$50,000 proceeds are donated to a charity. In the first situation, the security is sold and the cash proceeds are donated. In the second situation, the security is donated directly to a charity.

As the example shows, a donation of securities may be preferred over a cash donation of equal value, particularly if you have already decided to dispose of the securities during the year.<sup>7</sup>

### Estate donations

To encourage donations by bequest – in the year of death – the maximum donation that can be claimed is 100% of the deceased's net income. Any donations that cannot be claimed in the year of death can be claimed on the deceased's previous year's tax return, also up to 100% of net income in that year.

The strategy of donating appreciated publicly-traded securities can also be used upon death to potentially reduce tax to the deceased and create a significant donation to a charity. In the year of death, except for transfers to a surviving spouse or qualifying spousal trust, individuals are deemed to dispose of their capital property at its fair market value immediately before death, triggering any accrued capital gains or losses, which can result in a large tax liability at death.<sup>8</sup>

The strategy of donating appreciated securities at death can reduce this tax liability to the deceased (and/or the deceased's estate) by reducing the taxable portion of the deemed capital gains and providing a donation tax credit. Moreover, the tax legislation allows increased flexibility in the tax treatment of charitable donations in the context of a death (occurring after 2015). Specifically, a donation made by Will (and designated donations such as those designating a qualified donee as a beneficiary under an RRSP, RRIF, TFSA or life insurance policy) is considered to be made by the individual's estate at the time the specific property is donated to the qualifying charity. The value of the gift will therefore be the value at the time of the donation, and the estate can carry-forward any unused tax credit for five years from the date of gift.

If there is a gift of property acquired by the taxpayer's graduated rate estate<sup>9</sup> ("GRE") on, or as a consequence of, the taxpayer's death, the estate trustees can apply the donation tax credit amongst any of the following within the aforementioned annual donation credit limits:

- The taxation year of the estate in which the donation is made;
- An earlier taxation year of the estate; or
- The last two taxation years of the deceased individual.

Provided the securities are donated by a GRE, the special tax incentives eliminating the capital gains tax on a gift of appreciated securities could also apply to deemed dispositions of property on death. In the example presented in the following table, the net proceeds of an investment that is worth \$50,000 and has an unrealized gain of \$20,000 is calculated. Let's look at how making a charitable bequest of \$25,000 from this investment will impact the deceased's tax liability:

| Tax Benefit of a Donation Upon Death <sup>10</sup>                                       |             |           |                                 |            |
|------------------------------------------------------------------------------------------|-------------|-----------|---------------------------------|------------|
|                                                                                          | No donation |           | Donation of half of investments |            |
| Current value of investments                                                             |             | \$50,000  |                                 | \$50,000   |
| Capital gain                                                                             | \$20,000    |           | \$20,000                        |            |
| Taxable portion of capital gain <sup>4</sup>                                             | \$10,000    |           | \$5,000 <sup>11</sup>           |            |
| Income tax (50%) <sup>5</sup>                                                            |             | (\$5,000) |                                 | (\$2,500)  |
| Net cash to deceased's estate                                                            |             | \$45,000  |                                 | \$47,500   |
|                                                                                          |             |           |                                 |            |
| Less charitable donation amount                                                          |             |           |                                 | (\$25,000) |
| Add potential tax savings (vs. other income) from donation (\$25,000 @ 50%) <sup>6</sup> |             |           |                                 | \$12,500   |
| Net cash to deceased's estate                                                            |             |           |                                 | \$35,000   |
| Net cash to charity                                                                      |             |           |                                 | \$25,000   |

By donating half of the investment, the total tax liability on other income realized in the year of death can be reduced. So much so, that a \$50,000 investment provides the deceased's estate with after-tax proceeds of \$35,000, and also provides for a \$25,000 donation to a charity. In other words, it only costs the deceased's estate an incremental \$10,000 (\$45,000 – \$35,000) to make a donation of \$25,000 to a charity.

## Alternative Minimum Tax (AMT)

Introduced in 1986, the AMT is a parallel tax calculation for individuals (and many trusts) that calculates an alternate taxable income that allows fewer deductions, exemptions, and tax credits than under the ordinary income tax rules, and applies a flat tax rate on this adjusted taxable income (exceeding a standard exemption amount) instead of the usual progressive rate structure. A taxpayer ultimately pays the AMT or regular tax, whichever is highest. The 2023 Federal Budget introduced several changes to the AMT calculation, with the stated goal of better targeting high-income individuals, which were recently-enacted to be effective for the 2024 taxation year. Specifically, the changes include increasing the basic exemption for its application (to approximately \$173,000 of income, from \$40,000), broadening the AMT base, further limiting tax preference items (i.e., exemptions, deductions and credits) and increasing the AMT tax rate (to 20.5% from 15%).<sup>12</sup>

As a result of these changes, charitable high-income earners – particularly those who donate appreciated publicly-traded securities – should take note of the revised AMT because of two important revisions affecting donors. Specifically, although 100% of the capital gain realized on the donation of publicly listed securities to qualified donees is exempted from the (regular) income tax calculation, effective in 2024 and thereafter, 30% of capital gains (previously nil) realized on donations of publicly listed securities will now be included in the AMT base (mirroring the AMT treatment of capital gains eligible for the lifetime capital gains exemption). Secondly, only 80% (previously 100%) of the charitable donation tax credit will now be allowed for the purposes of the AMT calculation. Originally, this credit was proposed to be only 50% allowable, but the proportion was increased to acknowledge the concerns of the charitable community following the 2023 Federal Budget. Please see our *Alternative Minimum Tax* publication for a detailed overview of the broader changes to the AMT, and example calculations applicable to donors.

### AMT - Planning Considerations

As illustrated in our concept sheet *Alternative Minimum Tax*, most donors should not be impacted by the changes to the AMT, given the higher AMT exemption. However, individuals contemplating large donations – particularly gifts of appreciated publicly-traded securities – could now be subject to reduced tax savings as a result of the potential application of AMT, and therefore may need to carefully consider the amount and timing of their donations. This will often warrant a discussion with their tax advisors to perform

a “pro-forma” tax calculation to determine the potential AMT impact, *before the gift is made*, in order to ensure that there are no surprises at tax time.

In addition to planning to spread donations over several years and/or managing the level of taxable income (where possible), it is important to note some other strategies regarding the AMT, as follows:

- Additional tax paid as a result of the AMT can be carried forward for seven years and credited against regular tax to the extent regular tax exceeds AMT in those years. Accordingly, the AMT may not represent an absolute tax cost as it could be recoverable in the future with proper planning.
- The AMT does not apply in the year of death. Accordingly, a charitable bequest of cash or securities in-kind at death through your Will (as described previously) could be considered where AMT is a concern.
- Although corporations will be subject to the higher capital gains inclusion rate on all capital gains realized after June 24, 2024 (without the \$250,000 threshold available to individuals), AMT does not apply to corporations. Accordingly, charitably-minded individuals who hold an investment portfolio corporately may wish to consider donating publicly-traded securities held in their corporation, to achieve similar tax benefits as individual giving, as described subsequently in this publication.

For more information, please see our publication, *Alternative Minimum Tax*, and consult with your tax advisor to determine the potential impact of the the AMT to your charitable giving strategy.

## Donations of shares or proceeds acquired through employee stock options

When an employee exercises a stock option, the difference between the fair market value of the stock at exercise and the amount paid for the stock, known as the *employee stock option benefit*, is included in the employee’s income. Historically, this benefit has been treated as similar to a capital gain, with one-half of the benefit deductible from income (provided certain conditions are met). Where the stock option is in respect of a share of a Canadian-controlled private corporation (CCPC), the inclusion of the stock option benefit is normally deferred until the taxation year in which the employee disposes of or exchanges the share.

As a result of the recent changes to the capital gains inclusion rate, claimants of the employee stock option deduction will be provided with a basic one-third deduction of the taxable benefit for stock options exercised on or after June 25, 2024, or, in the case of a CCPC share, where the share is disposed of or exchanged on or after June 25, 2024. This deduction could be increased to one-half on up to a combined annual limit of \$250,000 for both employee stock option benefits and capital gains, at the taxpayer's discretion. However, although this benefit received on the exercise of employee stock options generally represents employment income – and not a capital gain – it is also possible to reduce or eliminate this employment income benefit by donating the shares or proceeds acquired through the exercise of employee stock options.

To be eligible for this incentive, the option shares must be publicly-traded securities and the shares (or proceeds acquired through exercising the options) must be donated to a qualifying charity. The stock option benefit must also be eligible for the 50% (or 33.33%) deduction available on the qualified exercise of certain securities.

However, if an employee donates a publicly-listed share acquired under a stock option that is subject to the recently amended tax rules which preclude the deduction for certain stock options granted after June 2021,<sup>13</sup> the employee will not be eligible for a tax exemption on any associated employee stock option benefit. Any capital gain that has accrued since the share was acquired under the stock option agreement will continue to be eligible for the full exemption from capital gains tax, subject to current rules.

Assuming these qualifications are met (and the rules restricting the deduction do not apply), the reduced income inclusion is available if the shares are donated in the year acquired and within 30 days after the option exercise. In addition, in the case of a "cashless exercise," the reduced income inclusion may also be available if the employee directs their financial professional to immediately dispose of the securities acquired from the employee stock options and deliver the proceeds to a qualifying charity. Note that if the value of the shares decrease in the (maximum) 30-day period before making the donation, or if only some of the shares (or aggregate proceeds) received by exercising the options are donated, the tax deduction will be reduced proportionately.

As noted previously in the AMT discussion for the donation of appreciated securities, there is a 30% add-back for AMT purposes applicable to the benefit associated with employee

stock options to the extent that a deduction is available because the underlying publicly-listed securities were donated. Combined with the 80% limitation to the donation tax credit for AMT purposes, as with donated securities, AMT could apply to reduce the benefit of these donation strategies in some instances. For further information ask your BMO financial professional for a copy of our publications, *Taxation of Employee Stock Options* and *Donating the Shares or Cash Proceeds Acquired Through Employee Stock Options*.

However, as the tax rules for employee stock options and the related rules that determine the AMT and the charitable donation credits are complex, please consult with your tax advisor to determine the appropriateness and the proper implementation of this strategy based on your situation.

## Corporate charitable giving

Corporate charitable giving can also provide the same tax benefits as individual giving, through:

- i. Potential elimination of any capital gains tax on a qualifying gift of publicly-traded securities;<sup>7</sup> and
- ii. A tax deduction equal to the fair market value of the gift.

A corporation will not receive a tax credit for the gifted qualified securities; instead it will be entitled to a deduction equal to the value of the gifted property. This will result in a reduction of the tax that would otherwise be payable on income earned by the corporation.

However, similar to individuals, corporations are also restricted on the amount of charitable deductions claimed annually. A corporation can deduct charitable donations up to a maximum of 75% of current year net income, with the potential to carry forward any excess for up to five years. For a Canadian-controlled private corporation which donates a qualifying publicly-traded security, the 100% non-taxable capital gain portion will be added to its Capital Dividend Account ("CDA").<sup>7</sup> This notional account, when positive, may be paid to shareholders on a tax-free basis, which could facilitate the withdrawal of funds from the company to its shareholders.

The following table briefly compares the tax benefits of donating qualifying securities personally, or corporately.

| Gift of Qualified Securities <sup>7</sup>                                                                                                                                                                                                                                                                                                                                                          |                                                                                                                                                                                                                                                                                                                                                                              |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Individual                                                                                                                                                                                                                                                                                                                                                                                         | Corporation                                                                                                                                                                                                                                                                                                                                                                  |
| <p>Federal and provincial personal tax credits on the gift value:</p> <ul style="list-style-type: none"><li>• Federal portion is 15% for first \$200, and 29% or 33% for amounts over \$200.</li><li>• Credits limited to 75% of net income (100% in year of death).<sup>2</sup></li><li>• Capital gain on qualifying security has 0% inclusion rate. (30% add-back for AMT calculation)</li></ul> | <p>Corporation may expense the gift value (up to 75% of net income) as a charitable deduction.</p> <ul style="list-style-type: none"><li>• Capital gain on qualifying security has 0% inclusion rate. Non-taxable portion of the capital gain is added to CDA and a positive balance of CDA may be withdrawn as a tax-free dividend.</li><li>• Not subject to AMT.</li></ul> |

Consider the tax benefits of charitable giving

In addition to the many benefits of charitable giving, there are considerable tax incentives when donating, especially when gifting appreciated publicly-traded securities. In light of the complexities of the tax legislation governing charitable giving – particularly involving estate donations and the recent changes to the Alternative Minimum Tax – please be sure to speak with your tax and/or estate advisors for assistance in developing and implementing your charitable giving strategies.

For more information, speak with your BMO Private Wealth professional.



<sup>1</sup> However, please see discussion herein on potential implications of the Alternative Minimum Tax (AMT).

<sup>2</sup> The 75% limitation does not apply in calculating the qualifying Quebec provincial donation tax credit. Also, note that gifts to foreign charities do not generally result in a charitable donation tax credit for Canadian tax purposes, although many foreign universities will qualify as well as a few specific foreign charities that have previously received a gift from the government of Canada may also qualify. In addition, the Canada-U.S. tax treaty provides some limited tax relief for gifts to U.S. charities. Under specific conditions, a donation claim may be made on U.S. gifts of up to 75% of the net U.S. source income reported on the Canadian tax return. The U.S. source income restriction may not apply under specific circumstances or on gifts made to certain registered U.S. colleges or universities referenced under publicly available listings maintained by CRA.

<sup>3</sup> For provincial tax purposes, the donation tax credit is generally calculated in a similar manner (i.e., the first \$200 of donation provides a tax credit at the lowest personal tax rate whereas the tax credit for donations exceeding \$200 is provided at the highest personal tax rate, with slight modifications for Alberta, Ontario, New Brunswick, Quebec and Yukon). In Alberta, the tax credit for donations both under and over \$200 exceeds the combined top marginal tax rates to provide additional charitable incentives. Ontario previously introduced an additional tax bracket for high income earners; however, the donation tax credit for gifts exceeding \$200 remains at the previous top tax rate. Similarly, the maximum donation tax credit in both Yukon and New Brunswick is less than the corresponding top marginal personal tax rate. Beginning in 2017, the Quebec provincial tax credit for donations greater than \$200 for individuals in the top marginal rate increased to match the top marginal rate. In addition, the Quebec tax credit for donations less than \$200 is calculated at the second lowest tax bracket resulting in an added benefit. Notably, corresponding with the 2020 increase in the top BC provincial marginal tax rate, the BC charitable donation tax credit (for donations over \$200) increased accordingly (for individuals subject to this higher rate).

<sup>4</sup> Assumes individual's net capital gains realized in the year do not exceed \$250,000, such that the 50% inclusion rate applies (vs. 2/3).

<sup>5</sup> Based upon an assumed top marginal tax rate.

<sup>6</sup> Assumed tax savings, provided that an individual who is subject to the top Federal tax bracket has made other donations of at least \$200 in the year and has sufficient other income to avoid the limit on donation claim to 75% of net income (100% in the year of death).

<sup>7</sup> Note that the tax benefits associated with a donation involving flow-through securities are limited by restricting the exemption from capital gains tax on the donation of flow-through investments to the excess of the (cumulative) capital gains over the original cost of acquiring the flow-through investments. Please consult with your tax advisor for further details.

<sup>8</sup> Particularly given the recent increase in the capital gains inclusion rate to 2/3 for annual net capital gains > \$250,000.

<sup>9</sup> After December 31, 2015, the graduated rate estate of an individual at any time is the estate that arose on, and as a consequence of, the individual's death, if that time is no more than 36 months after the death and the estate is at that time a testamentary trust. There can only be one graduated rate estate associated with an individual and it must designate itself as such in its T3 return for its first taxation year and include the individual's Social Insurance Number in its return of income each year after 2015.

This 36-month timeframe can be extended to allow the donation to be made up to 60 months after the individual's death, as long as the donation is from the estate that ceased to be the individual's GRE because the 36-month time period has lapsed and all other GRE requirements continue to be met at the time the donation is made. These further amendments effectively allow an additional two years to make a qualified donation; however, the additional flexibility for the donations made after 36 months (but before 60 months) following death is extended only to:

- i. The taxation year of the estate in which the donation is made; or
- ii. The last two taxation years of the deceased individual.

If the gift is not made by a GRE, to the extent that the deceased individual has tax otherwise payable in the year of death (such as capital gains resulting from the deemed disposition of investment assets), the executor would not be able to apply the donation tax credit to offset income in the deceased individual's final tax return (or the prior year). Given the donation is made by the estate, the donation tax credit in such a case could only be applied in the estate's taxation year in which the donation is made (or in any of its five subsequent tax years). Should the estate not realize sufficient income in the year the donation is made, or in any of its five subsequent taxation years, the benefit of the donation credit may be lost.

<sup>10</sup> Example assumes the investment security retains the same value at death as when donated by the estate and that the estate is a GRE.

<sup>11</sup> \$20,000 total gain less 50% non-taxable due to donation multiplied by (assumed) 50% inclusion rate.

<sup>12</sup> Notably, although only 50% (or 2/3) of a capital gain realized is included in income for regular tax purposes, for AMT purposes, 100% of the capital gain will be included effective in 2024 and thereafter (which is up from the 80% inclusion for AMT purposes in prior years). Since the new flat AMT rate for 2024 of 20.5% would exceed the top Federal regular tax rate on capital gains subject to a 50% inclusion rate (i.e.,  $16.5\% = 33\% \times \frac{1}{2}$ ), many individuals with large capital gains who claim offsetting deductions, exemptions or credits to substantially reduce their regular tax liability may be subject to the AMT in 2024. However, the potential higher capital gains inclusion rate of 2/3 will lessen the likelihood of AMT applying in these scenarios after June 24, 2024, since the top Federal regular tax rate on capital gains will increase to 22% (i.e.,  $33\% \times \frac{2}{3}$  inclusion rate), which exceeds the new flat AMT rate of 20.5%.

<sup>13</sup> Recent changes to the taxation of employee stock options could restrict access to this incentive. Please ask your BMO financial professional for our publication, *Taxation of Employee Stock Options* for further details.

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