



## The Limits of Planned Giving

In another article we looked at some of the basics of how the Income Tax Act treats charitable gifts. This time we'll examine the limits the tax system places on donations.

As we've seen, charitable donations create tax credits that reduce tax owing by approximately fifty cents. However, there are limits to how much a taxpayer can claim on his or her return.

Many of us are accustomed to the *twenty* per cent limit that was in effect for many years. In 1996 the limit was raised to *fifty* per cent of net income. In the 1997 budget the government raised the limit further to *seventy-five* per cent. Donations that go beyond the limit may be carried forward and used in any of the next five years following the donation.

For most of us, these limits are of little interest with respect to our regular charitable giving. Few Canadians, even faithful members of Lutheran congregations, give seventy-five percent of their annual income to their church or other charities on a regular basis!

But when it comes to planned gifts, the limits start to become relevant. That is because planned gifts are made from accumulated assets rather than from income. Particularly for people in their retirement years, the value of savings, investments and other property may far exceed annual income. Individuals in this position can consider a gift that approaches or exceeds seventy-five per cent of their net annual income.

This is particularly so if the donation takes the form of a bequest, i.e. a gift made through a will. Recognizing the importance of bequests to Canadian charities, Revenue Canada raised the limits on gifts made in the year of the donor's death (i.e. bequests) to one hundred per cent of net income in that year. This is accompanied by a one year carry-back provision for any amount that exceeds the limit. The limit in the prior year is also one hundred per cent of net income.

Let's assume that a donor has a fixed annual net income of \$40,000, and that she currently makes regular annual charitable donations totalling \$2,000. Since 75% of her net income equals \$30,000, she could claim an additional \$28,000 each year in donations. If she wished to make a large lifetime planned gift, she could donate up to \$168,000 with the intention of claiming the full amount during the five-year carry-forward period. Each year she can claim the \$2,000 regular donation plus \$28,000 of the planned gift. In six years — the year of the donation plus the subsequent five years — the full planned gift will have been claimed ( $\$28,000 \times 6 = \$168,000$ ). In that period the charitable credits generated by the planned gift will reduce income tax paid by approximately \$67,200.

If the donor chose to leave the same \$168,000 as a charitable bequest, the maximum her executor could claim on the final two years' tax returns would be \$76,000 plus the regular giving of \$2,000 per year (the limit equals 100% of \$40,000 times two). The credits generated by the bequest would reduce tax paid by approximately \$30,400. She and her heirs would have missed out on almost \$37,000 in income tax savings.

People considering a large charitable bequest should check the calculations to ensure that the full gift will qualify for tax credits. If not, it is to a donor's advantage to consider making at least part of the gift during his or her lifetime. Of course, there are other factors for a donor to consider as well. In a future column we'll examine the favourable tax treatment given to lifetime gifts of appreciated property.

*The numbers in this column are approximate and used for illustrative purposes. Consult a professional tax advisor if you need to know more about income taxes.*