Testamentary Charitable Donations

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The earlier articles in our "Wise Charitable Giving" series (October 2008 to March/April 2009) have discussed planning for donations made during your lifetime. This article looks at donations made through bequests in your Will or via beneficiary designations.

One drawback to making donations during your lifetime is the uncertainty of whether or not you are giving away too much. Since you will never know how long you will live, you have to be careful to preserve sufficient financial resources for your own needs. While your financial resources may seem sufficient at a particular time, recent market declines are ample evidence that your circumstances can change unexpectedly.

The appeal of making donations through your Will, rather than during your lifetime, is that it allows you to take care of your own financial needs first, and then to provide for charitable donations from the remaining value in your estate. Given that you can never be sure of the future value of your estate, it is advisable to allocate the amount of your donations as a percentage of your estate rather than as a fixed absolute dollar amount.

While kindness is the primary motivation for donating, it makes good sense to do some tax planning in advance to ensure that all available donation tax credits will be utilized. Donations made through your Will, benefit from the same tax credit as donations made during your lifetime except that the limitation is higher on death. During your lifetime, donations up to 75% of net income qualify for a tax credit. In the year of death and the preceding year, donations up to 100% of net income qualify for a tax credit.

How To Make Testamentary Charitable Donations

1.Specify a bequest in your Will in the form of:

- Cash,
- Marketable securities in kind (where there is an unrealized capital gain that would qualify for the 0% inclusion rate), and
- Other assets such as art, real estate, etc.

2. Name a charity as a designated beneficiary of a life insurance policy (see the March/April 09 article for additional information).
3. Name a charity as a designated beneficiary of a registered plan such as an RRSP or RRIF.
   - The value of an RRSP/RRIF would be included in your income in the year of death. The taxes on this income would be offset by the donation tax credits.
   - As a general rule, you should only consider donating an RRSP or RRIF if you do not have a spouse or dependent child/grandchild. RRSPs/RRIFs can roll to these individuals on a tax-deferred basis.

Pitfalls To Avoid

If you are going to make a sizable donation in your Will in relation to the rest of your estate, make sure that you've considered all the implications. Here are some common pitfalls:

- *The gift ends up being a larger or smaller portion of the estate than the testator originally envisioned.* - Consider a person who left a particular charity $500,000 out of a $1,000,000 portfolio, with the residue going to family members. What would the result be if the investment portfolio dropped to $700,000 as it might have in the recent financial crisis and the person died? The family members would get much less than the testator originally envisioned. In addition, if the deceased had a spouse and dependants, they might choose to challenge the Will. One solution would be to use percentages of residue rather than fixed-dollar amounts for large donations and to consider the overall percentage left to charities.

- *The estate has significant assets but the deceased had insufficient taxable income to use up the donation credits.* - Consider a single person who owned a principal residence, had a $30,000 annual pension and $250,000 in GICs yielding 4%. If the person left his home to his favourite nephew

and his GICs to his favourite charities, given his annual income of $40,000, only a small portion of the $250,000 would yield a tax saving in the year of death. Some additional savings would be realized from applying the donation credits to the prior year but most of the donation credits would not provide a tax benefit. Alternatively, the individual could have made ongoing donations during his lifetime. An annual donation of $10,000 for 25 years would have resulted in the same total gift, but the tax credit would have been fully utilized each year.

- *There are no assets left in the estate to satisfy the bequests in the Will.* - All taxable accounts are jointly held between spouses and the beneficiary of any registered (RRSP/RRIF) accounts is the spouse. On death, all taxable and registered accounts would go to the spouse. In this case, the individual has minimized probate and legal fees but there are no assets left in the estate to satisfy the donation bequest. It's important to pay close attention to administrative details like account registration and beneficiary designation.

- *You have given too much discretion to your executor.* - If you give too much discretion to your executor regarding the choice of charity or the size of the donation, the Canada Revenue Agency (CRA) could allege that the estate should claim the tax credit and could disallow the credit on your terminal return. If the estate has insufficient income to use up the tax credits, they may be wasted.

- *You make a large donation to a small charity without advising them beforehand.* To retain their charitable status, charities have to spend a certain portion of their income each year. Consulting with a small charity at the time of planning your testamentary donation ensures that they will be able to spend your donation wisely, and in a manner that reflects your wishes.

Conclusion

To successfully plan your testamentary donations you will need to know the following:

- How much excess capital you're likely to have after providing for your financial needs during your lifetime.
- How you'd like to distribute your estate, including minimum amounts to family members.
- The most tax-efficient means to accomplish your desired distribution.
- The estimated tax liability upon your death.

Once you've put in place an estate plan that avoids some of the pitfalls we've described, your estate plan should be reviewed annually to ensure that your current intentions are reflected in your Will.

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