Giving Money to Charity at or Near Death

By: Joe the Investor

If you want to give money to charity and you are planning your estate, what is the best way to do it? There is an option to give to charity each year or as a lump sum upon death. At the time of death, there are options to give to charity as part of your will, through life insurance or through donating assets. There are considerations to consider when making these choices:

What Is My Income Level and What Do I Need For My Lifestyle Now and At The Day of My Death?

If you have a high annual income (high would mean you are paying the highest tax rates) and you don't need this money for day to day expenses, then giving to charity while you are living may be a good idea. You can make this decision each year if your income fluctuates, or if you have a year where the income spikes such as a year when a property is sold or capital gains are harvested on investments. There would be a trade-off between lowering the tax rates currently, and lowering them for the estate. You also would want to consider how quickly you want to give to charity and whether you would like to see how your money is being utilized.

There are many personal opinions that surface with respect to charities and how it should be done, so some introspection is required to ask yourself what your preferred method of giving would be. It is a good idea to ask your favourite charities how they would like their donations – lump sum versus frequently, and assets versus cash. Some charities have difficulty dealing with large sums of money because they may not have the facilities to allocate it where they need it. Other charities may have unpredictable funding from other sources if large sums are donated which would disrupt their cash flows. Depending on the type of donation, a charity may earmark it for different uses and this would facilitate how the donations get utilized.

If I Give Donations at the Time of My Death, How Should I Do it?

Donating Your RRSP

What about donating RRSP, RRIF or LIRA accounts to charity? Why do this? These accounts may be taxed heavily depending on your income at the day of death and on the remaining balance at the day of death. This strategy is similar to donating shares that have large unrealized capital gains at death which could be nullified if the shares were donated to charity prior to sale.

Donating Through Your Will

The disadvantages are that the will can be contested or changed which may affect the intended outcome of giving to charity. There are also probate fees that apply to anything passing through a will.

Donation of Life Insurance Through a Will

This donation is made at death. Note that donation is made by the estate and at the time of death. Note that "cultural gifts" and "ecological gifts" are taxed differently. Donations can be claimed: in the taxation year of the estate in which the donation is made, an earlier taxation year of the estate, or one of the last two taxation years of the individual up to 100% of net income. The estate can also carry forward donation credits up to 5 years into the future if it is Graduated Rate Estate (GRE) or 10 years for ecologically sensitive land. Note that a gift given through a will or through the estate is treated the same way. The donation consists of a lump sum and the tax receipt is made to the estate and not the individual. There are probate fees, public disclosure and the possibility of estate contestability.

Donations of Life Insurance By Naming a Charity as a Beneficiary of the Insurance Policy

The individual in this case would not qualify for a charitable donation tax credit for the premiums paid. This would be done when an insurance policy is close to renewal or set to expire. If you let the policy expire by not paying premiums, you may not get any value for it or get cash surrender value which may be lower than its fair market value. Life insurance policies can be donated by 1) changing the assigning the charity as the beneficiary and upon death. The estate would receive a tax credit based on the amount of the gift. Another way is to 2) change the policy ownership and beneficiary to the charity. The charity should be consulted as to whether they would accept this kind of gift. This method is useful for direct donations as opposed to using third parties. Can the donation credit be used? It is worth 75% of net income at a maximum with a carry forward of 5 years.

Donations of Life Insurance Policies Directly To A Charity

In case 2), the fair market value is used which is typically higher than the cash surrender value. Who will pay the premiums once the insurance policy is donated? The insured can continue to pay premiums and get additional tax credits for the payments if they occur after the transfer of the insurance policy is made to the charity, or the premiums can be deducted from the policy's cash value. Other donors of the charity itself can also pay the premiums. The charity may prefer to pay the premiums since if the donor agrees to pay the premiums and does not, the insurance policy will lapse. Note that the features of the life insurance policy should be checked thoroughly to make sure to arrive at the correct fair market value. In the second case, there are no probate fees, no contestability of the estate and no issue with creditors and the estate. This case can apply to a new or existing life insurance policy during your lifetime. The remainder of the estate can be kept whole for the other beneficiaries. Donating a life insurance policy can be cheaper than giving a cash donation because investment income is being generated inside of the life insurance policy. Note that if there is a split of an insurance policy between a donor and a charity, the CRA does not want an advantage in favour of the donor. The benefits to the charity and the donor must be clearly separated otherwise the charitable tax deduction would not be allowed. The individual making the donation has to calculate the value of the split – which is likely performed with help from an insurance underwriter or actuary.

Donating Assets

This method is donating assets in kind where there is an unrealized capital gain or loss embedded in the transaction. This is called donating capital property and the total donation limit is increased by 25% of the taxable capital gain. The donor may designate a value between the ACB (Adjusted Cost Basis) and the FMV (Fair Market Value) of the donated property for calculating the capital gains and tax credit. If an insurance policy is purchased to replace the value of the assets donated (and offset the tax consequences of a capital gain), the tax savings from the gift can be applied toward the purchase of the insurance policy.

Donor Advised Funds and Foundations

A donor advised fund is an endowment fund. Monies are put into the fund and the fixed payout is made to registered charities. There is flexibility as to when donations are made and who to make them to. This can be used as a legacy of charitable giving since the donations can continue after death and be your heirs as well. The money is donated to an organization who invests the initial donation, administers where the proceeds are donated, invests the money guided by you and issues the tax receipts.

Sources:

https://www.advisor.ca/tax/tax-news/how-to-donate-a-life-insurance-policy/

https://advico.ca/charitable-giving-and-life-insurance/