April - June 2013

Be well-advised.

MONEY *matters*

REDUCE YOUR TAXES BY PHILANTHROPY AND PLANNED GIVING

While you may support different charities because you believe in their cause and your donation may be entirely based on your emotions, when it comes to your philanthropy, by having a strategic approach you can substantially reduce taxes on your income and the estate taxes payable after your death.

While gifts of cash, securities and life insurance during your lifetime can generate charitable donation tax credits for you that help reduce your taxes, deferred planned giving by making bequests to charities in your will, can help reduce taxes payable by your estate.

The most frequently used planned giving strategies include the following:

- bequests in wills
- charitable gift annuities
- life insurance
- charitable remainder trusts
- gifts of residual interest
- gifts of RRSPs and RRIFs

While you may need most of your financial resources to provide for yourself and your family during your lifetime, if you are interested in creating a lasting legacy

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Tina Tehranchian, MA, CFP, CLU, CHFC
Fellow of FPSC ™
Branch Manager
Senior Financial Planner

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"The new 25% super credit will be added to the existing charitable donation tax credit, resulting in a tax credit rate of 40% on the first $200 of donations and 54% on the next $800."

and giving a gift that keeps on giving after you are gone, then you should seriously consider the above strategies.

CHARITABLE DONATION TAX CREDIT

Donations made to charities in Canada are eligible for a charitable donation tax credit. The first $200 of your donations is eligible for a tax credit equivalent to 15% of the donation amount. Depending on your province of residence you can also claim a provincial tax credit of 4% to 20% of the donated amount. On average this amounts to a 25% tax credit, which means that you save $50 on a $200 charitable donation.

If your donations exceed $200, then you will receive a 29% federal tax credit and will be eligible for a provincial tax credit of 11% to 24%, resulting in an average refund of 45% of your donation.

Since you receive a tax credit that reduces the amount of taxes that you owe, rather than deduction from income, when you make a charitable donation, the tax savings are the same no matter what tax bracket you may be in.

If you cannot use your tax credits in the year of your donation, you can carry forward your donations for five years.

While during your lifetime, you can claim charitable donations up to 75% of your net income, the tax credits are more generous after your death. In the year of your death, you can claim donations of up to 100% of your net income and can carry back any excess donations to offset 100% of your income in the preceding year. If you make a donation through your will it will be treated as if it was made immediately before your death and can be deducted on your final return. Plus you will have the ability to carry back any excess donations to offset 100% of your previous year's income as well.

FIRST-TIME DONOR'S SUPER CREDIT

The 2013 federal budget, proposed a temporary one-time credit for first-time donors on up to $1,000 of monetary donations, in an attempt to encourage charitable giving by new donors. If a donor, or his/her spouse or common-law partner did not claim a charitable donation tax credit or this new credit in any taxation year after 2007, the donor would be considered a first-time donor and would be eligible for this new tax credit.

The new 25% super credit will be added to the existing charitable donation tax credit, resulting in a tax credit rate of 40% on the first $200 of donations and 54% on the next $800. The new credit applies to donations made after March 21, 2013 and before 2018. The maximum limit of $1,000 applies to both individuals and couples, so that there is no doubling of the credit for couples.

To maximize the tax credit, donors may want to carry forward and not claim smaller donations until the $1,000 threshold is reached as this is a one-time credit.

BEQUESTS IN YOUR WILL AND DONATION OF SECURITIES IN-KIND

Leaving a cash bequest to a charity of your choice in your will is one of the most frequently used vehicles for planned giving.

However, if you own stocks and bonds and other publicly listed securities with significant accrued capital gains, you should consider gifting them to a charity in your lifetime or in your will as the favourable tax treatment can shave thousands of dollars off the tax bill for your estate.

If you transfer publicly listed securities or mutual funds to a registered charity or registered private foundation, the capital gains on those securities will not be subject to tax. You will still be eligible for receiving a charitable donation tax credit based on the fair market value of the securities at the time of transfer to the charity.

If you acquire stocks with your employee stock options you can also donate them to a charity and not only the capital gains will not be taxable but your employment benefit that is included in your taxable income is eliminated as well.

You should note that if you acquired flow-through shares on or after March 22, 2011, a capital gain will be realized when donating them to a charity and the above rules will not apply.

CHARITABLE GIFT ANNUITIES

You can instruct the charity to use your donation to buy a life annuity that pays a guaranteed income based on your life expectancy. Part of the income will be treated as taxable interest income and part of it as return of capital and will be tax-free.

LIFE INSURANCE

Gifting a life insurance policy is another common strategy used for planned giving. This can be done in several ways.

You can purchase a policy on your own life and name the charity as owner and beneficiary. In this scenario you will receive a charitable donation tax credit for the premiums that you pay and the charity will ultimately receive the death benefit of the policy on a tax free basis.

If you have an existing life insurance policy, you can donate that policy to a charity and name the charity as the owner and beneficiary of the policy and receive a charitable donation receipt on the premiums that you pay for the policy. You will also receive a charitable donation receipt based on the cash surrender value of the policy at the time of transfer to the charity. Transferring a policy to a charity is a taxable transaction and may trigger capital gains taxes that will be taxable and do not benefit from the same treatment as in-kind transfer of securities to a charity.

"In the year of your death, you can claim donations of up to 100% of your net income and can carry back any excess donations to offset 100% of your income in the preceding year."

Another method of gifting a life insurance policy to a charity is to simply name the charity as the beneficiary of the policy. You will not receive any charitable donation receipt for the premiums you pay during your lifetime but at death, the charity will receive the death benefit of the policy and your estate will receive a tax credit. This will qualify as a donation made in the year of death and can be used to offset 100% of your net income in the year of the death and can be carried back to offset 100% of you net income in the prior year.

Yet another alternative is to name your estate as the beneficiary of the policy and make a bequest of the proceeds of the policy to the charity in your will. Generally you will be able to carry back the tax credit and offset 100% of your net income in the prior year. However, if the executor is given discretion in the amount that can be donated to charity then the CRA may consider this to be a donation by the estate and disallow the carry back.

Therefore, it is important that you consider the tax implications of each method and your desired outcome and discuss it with your lawyer to make sure your will is drafted accordingly.

CHARITABLE REMAINDER TRUSTS

If you need the income from your property or want to continue using it during your lifetime, but want to leave the property to a charity after your death then you could consider establishing a charitable remainder trust. To do this you would need to set up an inter vivos trust and transfer real property, works of art or stocks to the trust and name the charity as the capital beneficiary of the trust. You will receive a charitable donation tax credit based on the valuation made by an actuary of your residual interest in the property that is transferred to the trust and continue receiving the income from the property or have the use and enjoyment of it during your lifetime. The ownership of the property will vest with the charity once the property is transferred into the trust.

GIFTS OF RESIDUAL INTEREST

If you want to bequest your home to a charity after you death, but continue to use and enjoy it for as long as you live, then you can gift your residual interest in your home to a charity of your choice.

Upon transfer of your home to a charity you will receive a charitable donation receipt based on the residual value of the property, as calculated by an actuary. You have to deduct the tax credit within five years.

Since the sale of your principal residence is not subject to capital gains tax, the transfer of your residual interest in the property to the charity will not trigger any capital gains taxes. Also, by using this strategy your home will not form part of your estate and will therefore not be subject to probate fees.

GIFTING YOUR RRSP OR RRIF

If you have more than enough sources of income for your retirement and do not need the income from your RRIF then you may consider donating your RRSPs or the income from your RRIF to a charity of your choice and can receive a charitable donation tax credit for this donation. You can also designate the charity as the beneficiary of your RRSP or RRIF. This designation can be made on the plan or through your will. At death, the value of your RRSP or RRIF will be included in your income in your final tax return and will be fully subject to tax. Therefore, if you have a spouse, it is best to name him/her as the beneficiary of the RRSP or RRIF and let the proceeds rollover to your spouse free of tax.

CONCLUSION

By exploring different planned giving strategies and discussing them with your financial advisor, tax advisor, and lawyer, you can ensure that you are getting the maximum tax benefit from your philanthropy while helping the causes that you care for dearly.

THE BENEFIT OF HAVING YOUR ANNUAL FINANCIAL CHECK-UP

By Alan Wainer, CA, CPA (Illinois)

As a family-business advisor, whenever I meet with clients, we invariably discuss their goals, objectives and yes, even their dreams. In many cases, there are obstacles that can put a dent in these plans. Changes occur constantly in life: marriage, the birth of a child, a major purchase, divorce, retirement, illness and so on. Isn`t it curious that we check our house, our cars and even our bodies on an annual basis, however, when it comes to our personal financial affairs, we tend to ignore them until there is a problem or a major life event? Why do we do this? Well, that's a topic for a separate article, but I can provide you with a checklist for reducing your financial stress. (Think of me as your financial psychologist as many of my clients do.)

For your consideration, below is a list of my top 10 recommendations to jump start the process to improved financial health. Not only will your doctor be pleased with the results, but so will you.

1. Set financial goals (not just for first-timers): Both short- and long-term goals. Otherwise, it is like steering a rudderless ship. Articulate your thoughts by putting them on paper. Discuss them with your trusted advisor(s). Set predefined times to review and revise your goals accordingly. I review mine annually unless a major life event occurs in the interim.

2. Determine net worth (total assets less liabilities): What is your net worth today? Where you want it to be in a year from now? Where do you want it to be over the next five years? If you don't track it, you can't react to life events.

"If you transfer publicly listed securities or mutual funds to a registered charity or registered private foundation, the capital gains on those securities will not be subject to tax."

3. Budget: Do you know whether you are spending more than you earn? For example, look at your debt load and see which direction it is going. It is easy to have a false sense of security, given low interest rates, but they will not remain low forever. Develop a habit of tracking your cash flow. It is now much easier with the software packages that are available today. The payoff is enormous when you take the time to see if your money is being put to the best use.

4. Minimize income taxes: Take the time to spend with your accountant and ensure that the appropriate strategies are implemented to minimize your taxes.

5. Manage your debt: Review the makeup of your overall debt load. Can you lower the interest rate you are paying? Would consolidating your debt help in attaining a better rate? Is there an opportunity to convert non-deductible interest to deductible interest? Do you have a plan to repay your debt or to at least bring it down to a manageable level?

6. Account for up-coming changes in your life: There is no time like the present to adjust your financial plan to take into account a significant change in your life. For instance, retirement is becoming a significant factor as the baby boom generation ages.

7. Check your insurance coverage: Evaluate whether you have enough insurance - health, life, disability, long-term care, homeowner`s and auto - to name a few.

8. Review your wills and powers of attorney (POA): When was the last time you reviewed your wills and POAs? If you have had a major change in your life, such as having a child or going through a divorce, don`t ignore it just because you don't like talking about it. Do you have a will and POAs? Are you willing to take the risk that your assets will not go to those loved ones? A properly drafted estate plan should give you comfort and put you at ease; not the opposite.

9. Start your retirement planning: What I have learned both personally and in dealing with clients is that the earlier you start, the better off you will be financially.

10. What is your happiness factor?: This plan is all about what you want to do with your finances. It comes back to what your objectives, goals and dreams are. If you are not satisfied with them, then it is time to re-evaluate them.

Remember this is an annual process. When you have completed your current year`s checkup, set up an appointment for next year around the same time, (unless circumstances change in the interim), so that you stay the course. You will be much healthier, financially speaking!

Alan Wainer is a partner in the Audit & Advisory practice at Crowe Soberman LLP. Alan can be reached at 416 963 7121 or alan.wainer@crowesoberman.com.

ABOUT THE EDITOR

Tina Tehranchian MA, CFP, CLU, CHFC, is a branch manager and senior financial planner with Assante Capital Management Ltd. Assante Wealth Management is one of Canada's largest wealth management companies, offering integrated financial solutions to create wealth and prosperity for you and your family. Our 900 per www.assante.com advisors in 300 offices across Canada take pride in the exceptional service they offer to clients through trusted face-to-face relationships and a level of service excellence second to none. Money Matters is published as a special service for clients of Tina Tehranchian.

15 Wertheim Court, Suite 604, Richmond Hill, Ont. L4B 3H7
Tel: (905)707-5220 | Fax:(905)707-1035
Email: ttehranchian@assante.com
Web: www.tinatehranchian.com

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