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PROPOSED ELIMINATION OF TAX ON GIFTS OF PUBLIC COMPANY SHARES

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A. INTRODUCTION

In a news release during the recent federal election campaign dated January 7, 2006, the Conservative Party of Canada announced that a Conservative government would remove the capital gains tax on listed securities donated to charities.[1] Since the Conservative Party took office, many observers and members of the sector believe that this proposal will be included in the first budget this spring, since it would be generally popular and win the support of all parties in the fractured Parliament. The following provides a brief discussion of the current regime applicable to donations of listed securities in order to better understand the proposal and its impact on donors and charities.

B. CURRENT PROVISIONS

Generally, a taxpayer who disposes of property by way of gift is deemed to have received proceeds of disposition equal to the fair market value (FMV) of the property at that time under paragraph 69(1)(b) of the *Income Tax Act* (ITA). If the FMV of the property exceeds its adjusted cost base (ACB),[2] the taxpayer will realize a capital gain as a result of such a disposition. For most gifts of property, 50% of the capital gain is

[1] Available at www.conservative.ca/en/1091/38163.
[2] The ACB of property is usually the cost of a property plus any expenses to acquire it, such as commissions and legal fees. The cost of a capital property is its actual or deemed cost, depending on the type of property and how it was acquired. For more information on ACB, see *Interpretation Bulletin IT-456, Capital Property - Some Adjustments to Cost Base,* and its Special Release.

included in income for the year and is subject to tax.[3] For example, if an individual gifts an antique desk to a registered charity that she paid $100 for (the ACB) and which now has a FMV of $1,000, she will realize a capital gain of $900 and a taxable capital gain (the amount she will have to include in her taxable income) of $450. Of course, she will also be able to claim a donation tax credit pursuant to subsection 118.1(3) for the entire amount of the gift ($1,000 - assuming that this is her only donation, the value of the tax credit would be $264). This donation tax credit will offset the impact of the capital gain inclusion, but the donation tax credit would have had a greater impact on her tax situation if she had donated cash.

In the 1997 Budget, Parliament enacted paragraph 38(a.1) of the ITA, which reduces the inclusion rate on capital gains arising from a gift of various types of property,[4] including publicly traded shares, where the gift is to a qualified donee[5] **other than a private foundation**. This amendment was intended to apply only to gifts made after February 18, 1997, and before 2002. In October 2001, the Department of Finance announced that the measure was permanent and the 2001 Budget removed the reference to gifts made after February 18, 1997 and before 2002. The inclusion rate for such property is 25% of the capital gain, instead of 50%.

In contrast to the example above, a donation of publicly traded shares with an ACB of $100 and a FMV of $1,000 to a registered charity, other than a private foundation, will result in a capital gain of $900 but a taxable capital gain of only $225 (25% of $900). Again, the capital gain tax will be offset by the donation tax credit and the donation tax credit would have had a greater impact on the donor's tax situation if she had donated cash, but she is better off than if she donated the antique desk.

In a recent Special Report authored by Don Drummond, Senior Vice-President and Chief Economist,[6] TD Economics notes that from 1997 to 2000 (immediately after the reduction of the capital gains inclusion rate

[3] Paragraph 38(a).
[4] Paragraph 38(a.1) applies to a gift of "a share, debt obligation or right listed on a prescribed stock exchange, a share of the capital stock of a mutual fund corporation, a unit of a mutual fund trust, an interest in a related segregated fund trust (within the meaning assigned by paragraph 138.1(1)(a)) or a prescribed debt obligation."
[5] Subsection 149.1(1) of the ITA defines "qualified donees" to include donees described in sections 110.1 and 118.1 of the ITA: a registered charity; a registered Canadian amateur athletic association; a housing corporation resident in Canada constituted exclusively to provide low-cost housing for the aged; a Canadian municipality; the United Nations and its agencies; a prescribed university that is outside Canada; a charitable organization outside Canada to which Her Majesty in right of Canada has made a gift; and Her Majesty in right of Canada or a province. It has also been proposed to expand the list of "qualified donees" as defined in subsection 149.1(1) to include municipal or public bodies performing a function of government in Canada.
[6] Available at http://www.td.com/economics/special/dd0206_charity.pdf.

on gifts of listed securities to 25%) gifts of publicly traded securities to charities increased from $69.1 million to $200.3 million, and the share of total donations represented by stocks from 1.6% to 3.9% of all donations.

C. CONSERVATIVE PROPOSAL

When the Conservative Party announced that a Conservative government would remove the capital gains tax on listed stocks donated to charities it indicated that, in its view, “eliminating capital gains taxes on donations of listed stocks will put millions of dollars into this important sector – a sector which employs millions of Canadians whether as paid employees or as volunteers… Canadians should not be penalized when they contribute to charities. That is why we are eliminating this tax on charities.”

In effect, the Conservative proposal would mean that the tax benefit arising from a gift of publicly traded securities would be the same as if it were a gift of cash. Using the example above, the donor would not be taxed on any of the capital gain accrued on the shares and would receive the full benefit of the donation tax credit on the donation. This may result in a net benefit to the donor from choosing to donate publicly traded shares instead of cash, as more explicitly explained below.

Don Drummond, in the TD Special Report, compares a cash gift of $100 to a gift of publicly traded shares with an ACB of $40 and a FMV of $100 (see Table 1). If the proposal is put forward and accepted, a charitable gift of $100 cash will cost the donor $54 after the donation tax credit (at the top marginal tax rate of 46%), but a gift of $100 in securities will cost only $40. The donor will have paid $40 for the shares initially, but will receive a donation tax credit of $46. Granted, the donor is foregoing the benefit of the increase in value of the security (from $40 to $100), but the donor is also avoiding the tax on that increase ($14). “This seems like too good a deal for Canadians not to respond to in a major way,” says Drummond. “First, if there is an option, it is much more cost-effective to donate securities rather than cash. Second, total giving should increase greatly. The donor gets to determine where the money goes (provided it is a registered public charity), yet pays well less than half the cost.”

TAX ASSISTANCE FOR CHARITABLE DONATIONS BY INDIVIDUALS Of Cash Compared to Donations of Publicly Traded Securities			
	Type of Donation		
	Cash	Publicly Traded Securities Donated to Public Charities	
		Current Regime	Conservative Proposal
Fair Market Value of Donation	$100.00	$100.00	$100.00
Top Marginal Tax Rate	46%	46%	46%
Value of Charitable Donations Credit (A)	$46.00	$46.00	$46.00
Typical Cost Base of Security		$40.00	$40.00
Capital Gain on Security		$60.00	$60.00
Capital Gain Tax if Sold, not Donated		$14.00	$14.00
Tax Saved Due to Incentive (B)		$7.00	$14.00
Total Tax Assistance (A + B)	$46.00	$53.00	$60.00
Cost of Donation to Donor	$54.00	$47.00	$40.00
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D. CONCLUSION

If the Conservative proposal is enacted and the potential for donations of publicly listed securities increases, as predicted by Don Drummond, it will be important for charities and their advisors to become familiar with the impact of the proposed change in order to ensure that donors properly understand the tax consequences of choosing to donate such securities.

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