



Giving more for less – Maximize donations to charities

Not only do charitable donations provide individuals with the satisfaction of giving back to their communities, recent changes to Canadian tax laws now ensure that there has never been a more tax-advantaged time to give.

BY BORROWING TO INVEST YOU CAN SIGNIFICANTLY INCREASE THE AMOUNT OF YOUR DONATION AND YOUR TAX SAVINGS

Donating to charities has a strong tradition in Canada and is something many of us find very appealing. Not only are we giving back to those less fortunate but the government rewards us with a tax credit. If you currently donate or are thinking of donating in the future you may be interested in this strategy.

The charitable leverage strategy involves taking discretionary cash flow that you might otherwise use to fund an annual charitable donation and instead using

those proceeds to pay the interest on money you have borrowed to invest.

The interest payments on the loan are tax deductible, and you can use these tax savings to pay the tax on any investment income earned in the year. Remaining amounts can then be donated to the charity. At the same time, you now have a large lump sum amount invested that takes advantage of the benefits of compounding so that you can make a significant donation in the future.¹

AN IN-DEPTH LOOK AT THE ISSUES...AND THE OPPORTUNITIES

Normally when transferring the ownership of publicly traded securities like stocks, bonds, mutual funds and segregated funds to charity, the donor would have to pay tax on 50% of the capital gains realized from the assets' appreciation in value.

However, under a special government incentive program the donation of publicly traded securities benefits from a capital gains inclusion rate that is cut in half to 25%. In other words, any taxes owing from the disposition of publicly traded securities donated directly to a charity will be 50% less than if the donor had sold the property to make a cash donation – a significant tax savings.²



With the charitable leverage strategy the cash flow requirements are the same as if you were making an annual contribution. However, in addition to increasing the amount of the donations and the tax savings, this strategy allows you the flexibility to:

- Wind-up the program at any time
- Continue the program for as long as you like to maximize your donation and tax savings
- Hold back the annual donations if you need the money

HERE'S HOW IT WORKS STEP-BY-STEP

Step #1

Apply for an investment loan.

Step #2

The investment loan is then applied in a lump sum to purchase non-registered assets.

Step #3

Loan interest is paid with the annual discretionary cash flow that you were otherwise going to donate.

Step #4

Loan interest that is paid becomes a deduction on your tax return.

Step #5

Tax savings from the interest deduction less any tax on the investment income is donated to a charity each year.

As outlined above, it's a simple strategy – and it can make a big difference to your bottom line.

HOW BORROWING TO INVEST CAN WORK – CASE STUDY

Joe would like to start making annual charitable donations. He has \$3,000 of annual discretionary income eligible for contribution. Joe would like to maximize the amount of his charitable contribution and would like to accomplish this as tax efficiently as possible.

Here's how Joe's situation looks, using this leverage strategy:

Annual donation (discretionary income)	\$3,000
Investment return	7%**
Loan interest	6%
Taxable percentage of investment earnings	25%
Tax rate on investment earnings	30%
Marginal tax rate	46%

** Investment return is for illustration purposes only and is not indicative of future performance





DETERMINING THE AMOUNT OF THE LOAN

Joe's annual donation amount will carry an interest-only loan of \$50,000, calculated as follows:

$\frac{\text{Annual donation amount}}{\text{Assumed interest rate}}$	=	$\frac{\$3,000}{0.06}$	=	The amount of interest-only loan Joe can carry
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HOW JOE'S SITUATION STACK'S UP

The \$3,000 amount that Joe can afford to donate each year is now used to cover all borrowing expenses. The annual interest expense deduction provides Joe with tax savings, which less any tax on the investment income, is donated to charity.

WHAT IT LOOKS LIKE AT YEAR 10³

At the end of year 10, the value of the \$50,000 invested is \$48,358 (with the loan repaid) which, when combined with the donation of the annual tax savings, results in a total donation of \$58,531.

	Direct Annual Donation	Charitable Leverage
Annual cash flow	\$3,000	\$3,000
Total gross cash flow	\$30,000 (\$3,000 x 10 years)	\$30,000 (\$3,000 x 10 years)
Total donation	\$30,000 (a)	\$58,531 (b)
Total tax savings	\$13,389 (c)	\$20,222 (d)
Increase in donation*		\$28,531
Increase in tax savings**		\$6,833

* (b) – (a) ** (d) – (c)

As you can see, by utilizing this charitable leverage strategy Joe's cash flow requirements have not changed but he has nearly doubled the amount of his donations over the 10 years from \$30,000 to \$58,531. This not only benefits the charity but it also has increased his tax savings by \$6,833 – a win-win situation.

IDEAL CANDIDATES

- Individuals currently donating to charity or planning to
- Individuals interested in giving back to their community

TAKE ACTION

- Use the annual contribution amount to fund a leverage loan to maximize the donation amount and tax savings.

1. Borrowing to invest is suitable only for investors with higher risk tolerance. You should be fully aware of the risks and benefits associated with investment loans since losses as well as gains may be magnified. The value of your investment will vary and is not guaranteed, however, you must meet your loan and income tax obligations and repay your loan in full. Read the terms of your loan agreement and the investment details for important information and discuss with your financial advisor before deciding whether to borrow to invest.

2. This special treatment does not apply to publicly traded securities given to a registered charity that is a private foundation.

3. This illustration assumes that a specific percentage of loan interest is tax deductible. However, actual tax deductibility of loan interest depends upon a number of factors, with the Income Tax Act providing the framework for determining deductibility. Tax laws are subject to change and, therefore, tax treatment of illustrated figures cannot be guaranteed. Results for Quebec residents may differ due to the new interest deductibility rules introduced in the 2004 – 2005 Budget. Readers should consult their own tax and legal advisors with respect to their particular circumstances.



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