

## Giving more for less – maximize donations to charities



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TAX MANAGED STRATEGY 10

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

Donating to charities is 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.

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

The charitable leverage strategy involves taking discretionary cash flow that you might otherwise use to fund an annual charitable donation and instead use those proceeds to pay the interest on money you have borrowed to invest.

The interest payments on the loan are generally 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.

Another alternative is to continue to make your annual charitable donations but use the resulting tax savings to fund an investment loan. The investment loan is used to purchase non-registered investments. The loan interest is generally tax deductible and is paid with the tax savings from your charitable donations. The result being that you now have the potential to significantly increase the value of your non-registered investment portfolio over the long term by having a large lump sum invested that benefits from the effects of compounding, which can also be used to make an additional sizeable future donation if you so choose.

### 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<sup>1</sup>:

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

<sup>1</sup> Investment returns, interest rates and tax rates are for illustration purposes only.

#### Determining the amount of the loan

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

$$\frac{\text{Annual donation amount}}{\text{Assumed interest rate}} = \frac{\$3,000}{0.06} = \text{The amount of interest-only loan Joe can carry}$$

#### How Joe's situation stacks 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.

For illustration purposes only. This is a fictional scenario.

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

Normally when transferring the ownership of publicly traded securities like stocks, bonds, mutual funds and segregated fund contracts to charity, the donor would have to pay tax on 50 per cent 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 reduced to zero per cent. In other words, the tax on any capital gains arising from the disposition of publicly traded securities donated directly to a charity has been eliminated – a significant tax savings.

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 donations and tax savings
- Hold back the annual donations if you need the money

## WHAT IT LOOKS LIKE AT YEAR 10<sup>2</sup>

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 \$59,135.

	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)	59,135 (b)
Total tax savings	13,369 (c)	22,531 (d)
Increase in donation <sup>3</sup>		29,135
Increase in tax savings <sup>4</sup>		9,162

<sup>3</sup>(b) – (a)      <sup>4</sup>(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 10 years from \$30,000 to \$59,135. This not only benefits the charity but it also has increased his tax savings by \$9,162 – a win-win situation.

<sup>2</sup>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* (Canada) 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 as the deductibility of investment expenses incurred by an individual or trust are limited to the amount of investment income earned during the year. Readers should consult their own tax and legal advisors with respect to their particular circumstances.

## 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.

## IDEAL CANDIDATES

- Individuals currently donating to charity or planning to
- Individuals interested in giving back to their community
- Experienced investors with a long-term horizon and not averse to increased risk

It's important to remember that this strategy may not be appropriate for someone with a low risk tolerance.

## TAKE ACTION

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

Borrowing to invest may be appropriate only for investors with a 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. Preferred candidates are those willing to invest for the long term and not averse to increased risk. The value of your investment will vary and is not guaranteed, however you must meet the loan and income tax obligations and repay the loan in full. Please ensure you read the terms of the loan agreement and the investment details for important information. The dealer and advisor are responsible for determining the appropriateness of investments for their clients and informing them of the risks associated with borrowing to invest.



## INVESTMENT OPTIONS WITH MANULIFE INVESTMENTS AND MANULIFE BANK

**Manulife Mutual Funds** is a fund company that utilizes the talents of four principal asset management firms with proven track records of successfully managing money through different market cycles. Portfolio management teams are located across the world applying their local market knowledge to uncover promising investment opportunities for Canadians. Whether you are just starting out, accumulating wealth or nearing/in retirement, Manulife Mutual Funds has a comprehensive suite of investment solutions to help you meet your financial objectives.

**Manulife Segregated Fund Contracts** combine the growth potential offered by a broad range of investment funds, with the unique wealth protection features of an insurance contract. Through Manulife segregated fund contracts, investors can minimize their exposure to risk through income, death and maturity guarantees, potential creditor protection features, and estate planning benefits – all from a single product or insurance contract.

**Manulife Bank Investment Loans** allow investors to make a large initial investment contribution and benefit from the potential for compound growth and interest deductibility. These loans are available for a variety of Manulife Mutual Fund accounts and Segregated Fund contracts, and offer attractive options such as 100 per cent financing, no margin-calls, interest-only payments and a one-step application process.



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