

Charity + tax-free dividends = a corporate win-win equation



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TAX MATTERS

I recently heard a story about a charitable woman. A poorly dressed man was standing on a street corner below the window of her apartment. She noticed that several passersby had stopped to give him money. She was touched by their generosity.

So, she wrote "Take Courage" on a piece of paper, put it in an envelope with a 10-dollar bill, then

tossed it to the man below. A few days later, when she was returning to her apartment, the man stopped her and said: "Here's your \$200 lady. 'Take Courage' won at 20 to one."

Whether the story is true or not, the woman's charitable intentions were "on the money." As the days pass since the last federal budget, tax professionals are devising creative new ways to give to charity, given the proposed changes to Canadian tax law around the donation of securities. Let me share an idea that comes courtesy of accountant Sandy Stedman of the firm Schibli Stedman King in Victoria.

This strategy works wonders for those who have corporations and are looking at ways to help charity,

but also for creative ways to take money out of the corporation on a tax-free basis.

The background

On July 8, I wrote about the tax benefits of donating flow-through shares to charity. To recap, flow-through shares offer a tax deduction for the amount invested. Because of this tax break, our tax law generally sets the adjusted cost base of the shares to zero. So, when you sell the shares, you'll have a capital gain.

Thanks to the changes in the last federal budget, a donation of flow-through shares to a registered charity will result in the taxable capital gain on those shares being eliminated. So, you won't face tax on the capital gain, and you'll be

entitled to a donation tax credit for the value of the shares when you donate them. In the end, it's possible that your donation will cost you just 8 cents for each \$1 donated (if the value of your flow-through shares remains unchanged, and you're in the top marginal tax bracket. Savings will vary by province).

The strategy

Your corporation can also make an investment in flow-throughs and donate those securities to charity. This will open the door to tax-free dividends from your company. You see, your company has something called a "capital dividend account" (CDA).

It's a notional account that increases in amount every time your

company realizes a capital gain (or receives certain other tax-free amounts, such as life insurance proceeds). The tax-free portion of post-1971 net capital gains is added to the CDA.

You're able to pay yourself tax-free "capital dividends" to the extent your company has a balance in its CDA. So, a \$10,000 donation of flow-through shares to charity will trigger a \$10,000 capital gain in your company (because flow-through shares generally have a zero adjusted cost base). Since 100 per cent of this gain is tax-free (thanks to the new rules around donating securities), the CDA of the company is boosted by the full capital gain of \$10,000, in our example.

In the end, the charity receives

\$10,000, your company faces no tax on the gain on the flow-through shares, the company is entitled to a tax deduction for the \$10,000 donation to charity, and your company's CDA is increased by \$10,000, allowing you to take \$10,000 tax free from your company as capital dividends. It's all good.

It's critical to know the true balance in your company's CDA, and the calculation is complex, so be sure to visit your accountant before implementing this idea.

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