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Marmer Penner Inc. Newsletter

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Tax-Free Capital Gains Arising From Charitable Donations

Our last newsletter began with the following:

"What are the objectives of the *Child Support Guidelines* that apply to those of us who calculate such income? The words "fair" and "consistent" in Section 1 of the *Guidelines* should resonate in our minds."

Apparently, the example we shared in that newsletter isn't the only inconsistency we have seen recently. Consider Mr. Goodheart, a high-income executive who makes sizable annual charitable donations from his even more sizable employment and investment income. In 2020, he donated $100,000 to a number of registered charities from his sources of income. He lowered his 2020 income tax liability by making such donations. When it came to calculating his *Guidelines* income, it consisted of his employment and investment income with no consideration given whatsoever to the donations he made. The *Guidelines* do not consider such voluntary expenses even if *The Income Tax Act* ("*The Act*") recognizes such deductions or credits.

Compare this to Ms. Smartheart. She is the heiress to a family fortune and makes charitable donations regularly as well. She has invested wisely and many of her investments in marketable securities have increased in value. Her accountant recommended to her that, if she was planning to donate $100,000 to charity, she would save tax if she donated $100,000 of, say, TD Bank shares which she purchased for $10,000 and currently have a $90,000 unrealized gain. If Ms. Smartheart sold the TD Bank shares, deposited the proceeds in her bank account and then wrote a $100,000 cheque to some charity, she'd be required to report a $45,000 taxable capital gain. Her tax in 2020 on that would have been over $24,000. However, she followed her accountant's advice and donated the $100,000 of shares directly to the charity. The charity was indifferent to receiving the $100,000 in cash or in such shares. But, *The Act* reduces to the taxable portion of a capital gain from 50% to nil on donated securities. Both Mr. Goodheart and Ms. Smartheart made the same $100,000 donation and received the same donation credit on the $100,000. But, Mr. Goodheart paid income tax on all of his capital gains in 2020 and Ms. Smartheart saved $24,000 of tax on her capital gains by taking advantage of a rule in *The Act*.

Many prudent investors structure their portfolios to earn capital gains and dividends because of the preferential tax rate applied to these sources of income. Paragraph 19(1)(h) of the *Guidelines* permits a court to impute an income tax gross-up to increase a spouse's income in situations where a significant portion of a spouse's income arises from lower-taxed income such as capital gains and dividends. Tax rates don't get much lower than zero percent. Accordingly, one would expect that taking advantage of a zero tax rate on capital gains from donated shares would increase a spouse's *Guidelines* income.

On multiple occasions, we have been opposite chartered business valuators who do not apply any income tax gross-up on these untaxed capital gains (let alone the normal gross-up if just half the gain was taxed) on the basis that the spouse did not have use of the proceeds from the capital gain as they were donated to a third party. We generally respond as follows:

a) The *Guidelines* calculate a spouse's income without caring how the spouse chooses to spend his/her money. Whether a spouse spends his/her money on charitable donations or vacations, the money is no longer there; and

b) Charitable donations can bring the donor as much pleasure as taking an expensive vacation so arguing that "the spouse did not have use of the proceeds" is not necessarily so.

In our minds, the words "fair" and "consistent" combined with the intent of 19(1)(h) require the same income tax gross-up on capital gains from donated shares at a bare minimum. That places Ms. Smartheart at no advantage to Mr. Goodheart. However, she is $24,000 better off than Mr. Goodheart so the benefit from her tax structure is equivalent to about $50,000 more in equivalent pre-tax or *Guidelines* income.

We are pleased to announce that Mr. Timmy Cheng, BAFM, MAcc has joined our firm. Timmy has written the exams for his CPA designation and is awaiting the results. Timmy has experience in matrimonial litigation accounting and has hit the ground running at Marmer Penner Inc.