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TD Economics

Special Report

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WIN-WIN STRATEGIES FOR RETIREES AND CHARITIES IN CHALLENGING TIMES

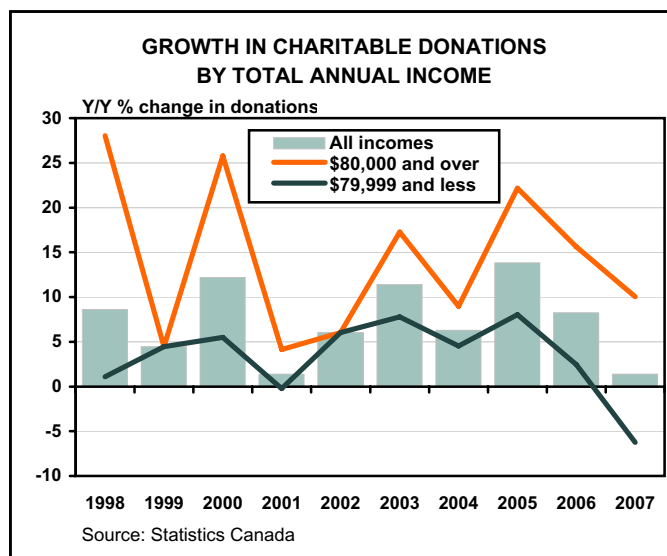
The window of opportunity to make charitable donations in 2008 is rapidly closing. Although many Canadians will be thinking about putting money into retirement savings plans in January and February in order to reduce tax payments or to increase tax refunds, many forget that the deadline for making charitable donations eligible for tax credits in the upcoming submission to the Canada Revenue Agency is December 31st.

Need for giving increases during recessions

Donations are badly needed at this time. Growth in donations has been slowing over the past three years. And, while donations rose at a meager 1.4% in 2007 to just over \$8.6 billion (with 24% of all taxfilers contributing), the prospects for 2008 and 2009 are even bleaker. The deep correction in equity prices makes donations of stocks and other financial assets less likely. Meanwhile, the outlook for a Canadian recession might lead some individuals to con-

HIGHLIGHTS

- **December 31st deadline to make donations in the 2008 tax year is rapidly approaching.**
- **Charities need donations now more than ever, as the economy heads into recession**
- **Charitable giving should be a key part of long-term financial planning and tax minimization strategies.**
- **Mandatory income withdrawals from RRIFs provide baby boomers with an opportunity to give and reduce their tax burden.**
- **Tax impact could be significant, as population turning age 71 expected to almost double by 2020; total pool of RRSP assets could exceed \$1.8 trillion**



template lower donations. This is understandable when income is advancing at a slower pace and unemployment is rising, but the timing of any reduction in giving is lamentable.

During more difficult economic times, the demand for many charitable services will increase. At the same time, weaker government revenues and the possibility of government deficits are likely to temper government transfers to non-profit organizations – and government financial support is critical to many of these institutions. This creates a perfect storm for charities, as demand increases and financial capacity wanes. Consequently, it is more important now than ever that Canadians help charities to weather the storm.

IMPACT OF CHARITABLE DONATIONS ON RRIF PAYMENT WITHDRAWAL				
	Quebec	Ontario	Alberta	B.C.
Taxable Income	\$150,000	\$150,000	\$150,000	\$150,000
RIF payment*	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Marginal Tax Rate	48.22%	46.41%	39.00%	43.70%
Tax payable on RRIF payment	\$ 4,822	\$ 4,641	\$ 3,900	\$ 4,370
Donation = RRIF payment	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Marginal tax credit rate	48.22%	46.41%	50.00%	43.70%
Tax savings from donation **	\$ 4,822	\$ 4,641	\$ 5,000	\$ 4,370
Tax payable on RRIF payment after donation	0	0	-1,100	0

* assumes no withholding tax
 ** assumes this in addition to \$200 of other donations
 Source: TD Wealth Management

Charitable giving as part of tax planning

Returning to the looming deadline for making charitable donations for the 2008 tax year, one of the themes we have written about many times in the past is the advantages of taking an investor approach to charitable giving. Philanthropy is a noble action, but it doesn't have to be done in a purely altruistic manner. The goal should be to maximize one's giving at the same time as taking the maximum advantage of the tax system.

After the first \$200 of donations, the Government of Canada provides a federal tax credit of 29% on charitable donations to encourage support of charities. You can donate up to 75% of your annual net income and you can carry forward any donations that are not claimed in the current year over any of the next five years. The provincial governments also provide tax credits, which means that donations receive federal and provincial tax credits equal to, or in a couple of cases more than, the personal marginal tax rate. In Ontario, for example, an individual in the top marginal tax bracket will receive a credit of 46 cents for every dollar donated after the first \$200.

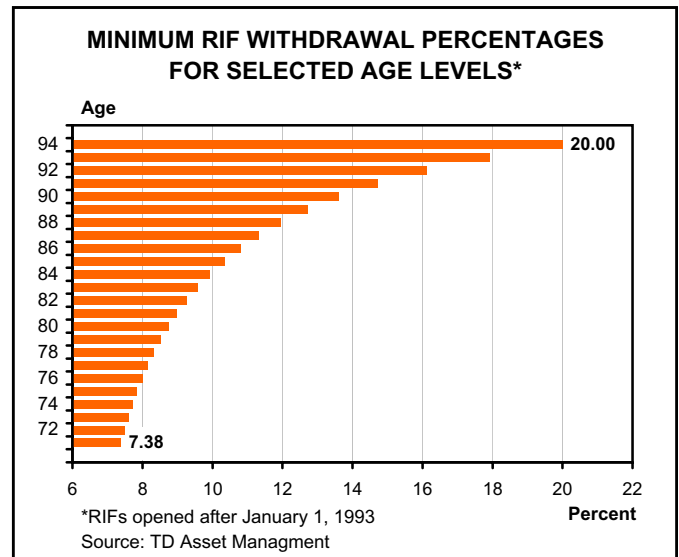
RRSP to RRIF conversion provides an example

Many Canadians are very familiar with the tax credits on charitable giving, but there is less appreciation on how charitable giving can be used actively to address life events. One example that we have discussed in the past is the use of donations of securities to help offset the tax impact of realizing capital gains on investments (www.td.com/economics/special/ca0308_charity.pdf).

This year, we would like to highlight another example for baby boomers, which is how charitable giving can be used to address the tax implications from the mandatory income withdrawals from registered retirement income funds (RRIFs).

Registered retirement saving plans (RRSP) have been hugely popular. The RRSP is an investment account that provides a tax credit on contributions, while capital gains or income generated in the account are tax free. Taxes must be paid on withdrawals from RRSPs. However, RRSPs don't last indefinitely, so the tax man must be ultimately paid. By December 31st of the year that you turn age 71, the RRSP must be rolled into a RRIF (the transfer may be in-kind). Each following year, a mandatory income withdrawal is required from the RRIF that is taxed at the owner's marginal tax rate. The minimum percentage withdrawal starts at 7.38% and steadily escalates in each subsequent year.

Many baby boomers will need the income from their RRIFs for living expenses; but, for some that have signifi-



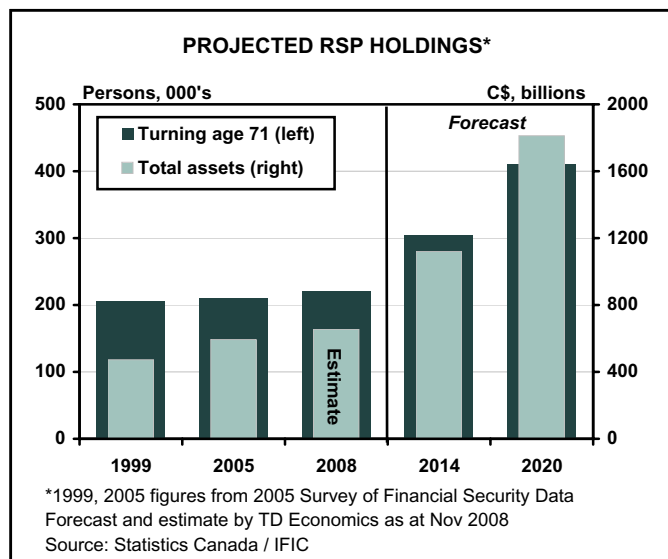
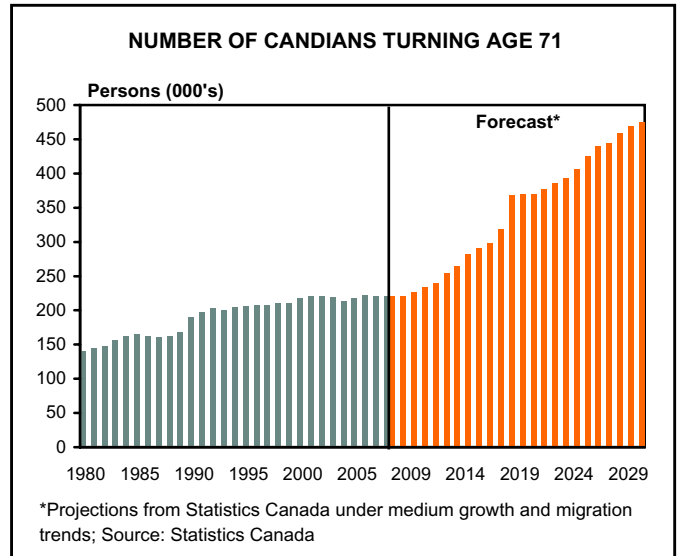
RECENT RRIF WITHDRAWAL PROPOSAL

In the November 27 Economic Statement the Federal government proposed a change to the RRIF income withdrawal rules to reflect the temporary drop in financial market valuations. Specifically, the proposal is a one-time change that will allow RRIF holders to reduce their required minimum withdrawal by 25% for this tax year.

cant other income sources the funds from the mandatory withdrawal are not needed. In the case of the latter, charitable donations can offset or reduce the tax hit.

An example is useful. Nicole, age 70, lives comfortably in Ontario drawing \$150,000 per annum from a variety of sources, not including any funds from her well-managed RRSP. In her 71st year, Nicole's RRSP is converted into a RRIF. In her 72nd year, 7.38% of the funds in her RRIF are withdrawn. Let's say that the RIF starts with a value of \$135,501, so the first year of mandatory withdrawal is a nice round figure of \$10,000. Since Nicole is in the top marginal tax bracket of 46.4%, she will owe the government \$4,640 in taxes on the RRIF funds.

Nicole is philanthropically inclined and she is living comfortably on her regular income. She is also thinking well



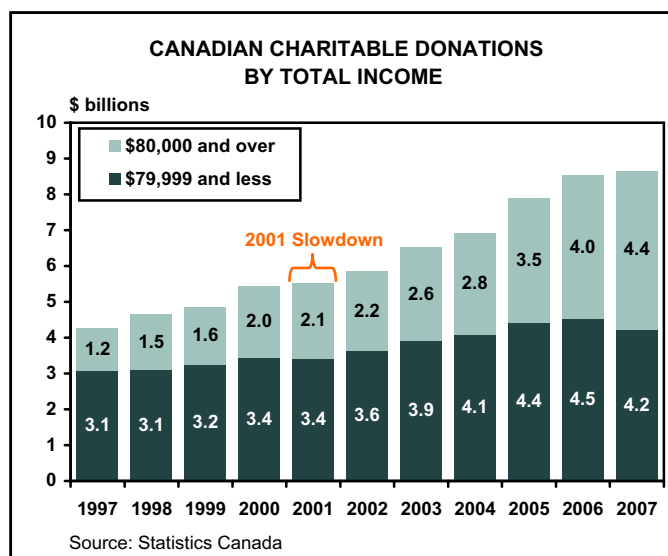
ahead and plans to make gifts from her estate when she passes away. Rather than waiting until her final years, or upon her death, to make donations to her favorite charities, she elects to start giving immediately. By donating an amount equal to her RRIF withdrawal, Nicole receives a charitable tax credit at a rate of 46.4%, precisely what she would have had to pay in taxes. Had Nicole lived in Alberta, the story would have been even better because the charitable tax credits are higher than personal marginal tax rate (see example).

Impact could be significant

If baby boomers were to embrace this approach to giving, it would be a significant boon to charities. We estimate that even with the recent financial market correction, there could be \$655 billion in RRSP assets in 2008. Using a financial return assumption of 5.75% per annum, and a conservative net contribution assumption, the total pool of RRSP assets could reach over \$1.8 trillion by 2020.

The bulk of the holdings will be with baby boomers in the highest tax brackets. In recent years, roughly two-thirds of all RRSP contributions were made by Canadians with annual incomes greater than \$60,000. And, there has been a sharp increase in contribution rates this decade amongst those with annual incomes above \$80,000.

The aging population also reveals that more and more Canadians will be forced to roll RRSPs into RRIFs in the coming years. Around 217,000 Canadians turn age 71 each year at the moment, but by 2020 this number will have almost doubled to 411,000 annually.



Conclusions

Philanthropy has become more fashionable in recent years. A greater number of donors shifted from simply bequeathing funds to becoming 'venture philanthropists.' This group actively tackles challenging social issues with the same zeal that made them successful in their own right. High profile and wealthy individuals like Bill Gates, U2's Bono and Warren Buffet have been leading the charge. But, you don't have to be ultra-rich to give. Many Canadians are inclined to be generous and have the financial capacity to do so. However, too often donations are left to be made through the estate or in the final years of life.

This can often mean that tax credits are lost. For example, the donations could exceed the government limits that are tied to annual income. A superior approach is to incorporate charitable giving into your ongoing financial plan. The tax system provides generous incentives for giving and the incentives are there to be used. Canadians are encouraged to talk to their financial advisers about how charitable giving and tax minimization can complement one another. And, if the donations can be found in the near term, it would surely be appreciated by charities that are facing challenging times.

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