TD Bank Financial Group

TD Economics

Topic Paper

AN INVESTOR APPROACH TO CHARITABLE GIVING

In recent years, TD Economics published several reports on the state of charities in Canada and came to the conclusion that the sector is under intense pressure. Difficulty finding skilled staff and adequate stable long-term financing were at the top of the list of major challenges. Given that the non-profit sector (including volunteer work) represents close to 6.9 per cent of the Canadian economy, these findings were troubling, to say the least. However, rather than harping on the growing need for increased philanthropy, we have decided to look at the issue from a completely different angle. While charities desperately require additional contributions, the key question from the point of view of donors is how to get the most bang for their buck. After scrimping and saving, Canadians are entitled to ask how they can best invest in the charitable sector, and we believe that a number of lessons from personal financial planning can be applied to charitable giving.

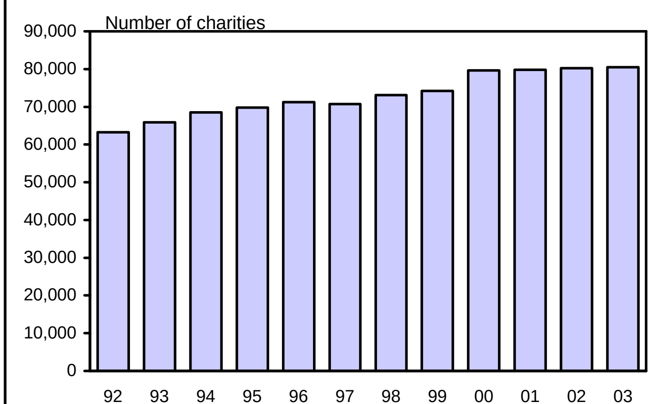
Develop a philanthropic plan

As a starting point, every investor needs to build a financial plan, and charitable giving can be included in that plan. An outline of the goals should be established and then a road map can be built as to how to achieve the objectives. And, the financial/philanthropic plan will not be static. It will change with life's events, meaning that it should be reviewed and updated periodically.

Understand the charity

Just like choosing investments, donors should ensure that they understand the charity to which they are giving funds. For example, how will the donations be used? How much support does the charity receive from governments and how reliant is it on personal donations? How much of the charity's funding goes to administrative outlays and how much is channelled to the end user of the charitable service? Donors should bear in mind that administration costs are a necessary burden for the provision of the services. The issue from an investment point of view is whether the charity is keeping those costs under control to the greatest extent possible. The main message is that individuals should conduct some due diligence, just as they should do with any investment. And, the good news is that recent regulatory changes, which require an increase in transparency by charities, will make it easier to do that.

CHARITIES IN CANADA



* From 1992-1999 number of charities that filed a tax return, from 2000 to 2003 number of registered charities

Source: Canada Revenue Agency

Think about diversification

Donors may also want to consider spreading their philanthropy across a number of charities. Although philanthropic diversification is not as critical as investment diversification, it is worth noting that there are more than 80,000 registered charities in Canada spanning a broad array of sectors and many are experiencing financial strains. With charities in fields ranging from the arts to the sciences, as well as across all provinces and around the globe, the need for donations is widespread. Moreover, after some reflection, most Canadians will discover that their social priorities are not limited to a single cause.

Give for the long haul

Donors should consider developing a long-term strategy for giving. From an investment perspective, investors are encouraged to avoid timing the market, instead choosing to make regular contributions to savings plans in order to take advantage of dollar cost averaging. With charities, the motivation is different, but the recommendation is the same. The number one problem identified by charities is difficulty obtaining long-term stable funding. As a result, charities benefit tremendously when individuals make regular donations. This is not to suggest that periodic financial windfalls should not motivate additional giving, or that each and every individual donation needs to be part of a long-term plan. Indeed, charities have immediate needs, such as raising funds for the purchase of specific equipment (e.g. an MRI machine), but they also have long term strategic needs. So, a balanced approach to giving would be superior, and to the extent that individuals want to provide sustained support, some thought should be given to the establishment of an endowment fund.

Estate planning can have a charitable dimension

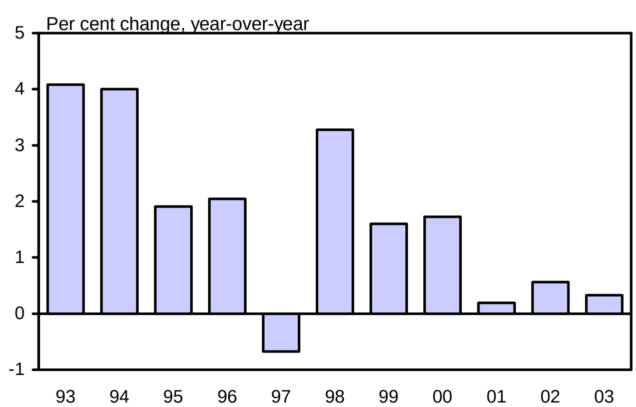
Estate planning is an important segment of personal financial planning, and charitable giving can be part of this process as well. Many individuals may wish to leave a legacy through charitable giving, while beneficiaries of inheritances may also wish to use the opportunity to make a philanthropic gesture. Like any major financial decision, these actions should not be done on a whim. Given the emotions that can surround the death of a family member or a close friend, it is preferable to make plans well ahead of time to ensure that the details of the giving are allowed the appropriate consideration. For example, the selection of which charities will be recipients, as well as whether the donations will be one time gesture or a continuing legacy through the creation of an endowment fund, can all be made well in advance. And, if charities are made aware of these intended donations, it may help them plan for the future.

NON-PROFIT ORGANIZATIONS, 2003

	Number	Registered Charities %
Sports & recreation	33,649	27
Religion	30,679	94
Social Services	19,099	72
Grant-making & fundraising	15,935	79
Arts & culture	13,770	54
Development & housing	12,255	23
Business, associations & unions	8,483	7
Education & research	8,284	55
Health	5,324	79
Environment	4,424	41
Law, advocacy & politics	3,628	35
Other	3,393	32
International	1,022	75
Hospitals	779	87
Universities & colleges	502	71

Source: Statistics Canada

GROWTH IN THE NUMBER OF CHARITIES IN CANADA*



Source: Canada Revenue Agency
*1993-2000 is based on the number of charities that filed a tax return, 2001-2003 is based on number of registered charities

NON-PROFIT ORGANIZATIONS, 2003
By Province or Territory

	Non-profit Organizations (number)	Registered Charity (Per cent)
Canada	**161,227**	**56**
Quebec	46,326	47
Ontario	45,360	60
British Columbia	20,270	56
Alberta	19,356	57
Manitoba	8,220	62
Saskatchewan	7,963	61
Nova Scotia	5,829	65
New Brunswick	3,890	68
Newfoundland & Labrador	2,219	57
Prince Edward Island	943	59
Territories	851	37

Source: Statistics Canada

Financial decisions should be based on all assets

When individuals build a personal financial plan, they include all of their assets and liabilities in formulating the strategy. The same is also true of charitable giving. Donations do not need to be solely in cash. Indeed, financial assets (including stocks, bonds and mutual funds) and real assets (like real estate and jewelry) can be donated. Indeed, as we will discuss below, there can be a huge tax savings from donating financial securities.

Maximize the use of tax credits

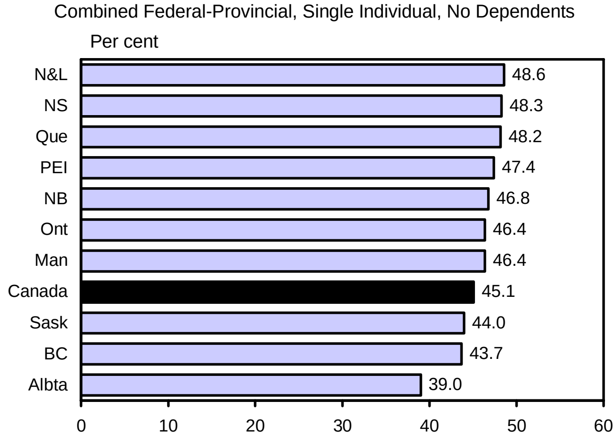
Just as investors strive to maximize the return on their investment, charitable givers should maximize the availability of tax credits. On the initial $200 of donations each year, Canadians receive a federal tax credit of 16 per cent of the donation, which can result in a combined federal and provincial tax credit of around 25 per cent. Beyond $200, the federal tax credit rises to 29 per cent, which can amount to a combined federal and provincial tax credit as high as 45 per cent.

It is important to stress that donations do not have to be claimed in the year in which they are made and can be carried for up to five years. As a result, individuals who make small contributions may want to wait until they exceed the $200 threshold in order to maximize their tax credits. Similarly, donations by individuals in a household can be pooled together to exceed the $200 mark and claimed on the tax return of the person with the higher tax rate.

It has also become highly attractive to make donations of financial securities, rather than cash. In the 2006 Federal budget, donations of publicly-listed securities were made exempt from capital gains taxation. This is a huge opportunity for many investors. Overall, Canadians have accumulated $700 billion in capital gains in their personal stock portfolios, and this amount could reach $2 trillion over the coming decade. The 2006 budget also allowed the capital gains exemption to donation of shares acquired through the employee stock options if the gift is made within 30 days of exercise

TOP MARGINAL TAX RATES: 2007

Combined Federal-Provincial, Single Individual, No Dependents



National average based on weighted average of tax payers by

Source: KPMG, TD

REGISTERED CHARITIES, 2003 By Revenue Source	**Per cent**
Revenues from government	
Payments for goods & services	18.5
Grants & contributions	35.6
Total revenues from government	**54.0**
Income from non-governmental sources	
Charitable gaming	1.1
Membership fees	2.9
Fees for goods or services	16.3
Investment income (including interest)	4.5
Total income from non-governmental sources	**24.7**
Gifts & donations	
Individual donations	11.2
Fundraising organizations	1.5
Other non-profit organizations	2.3
Corporate sponsorships & donations	3.1
Total gifts & donations	**18.1**
Total other income	**3.2**

Source: Statistics Canada

One should also take note, there is also a benefit to giving during one's lifetime, rather than through an estate, to avoid probate and executor fees.

Choosing between direct and indirect giving

Finally, one of the key issues in financial planning is the decision about whether to pursue a self-directed approach or to have someone else to manage your investments. People often do not realize that they have somewhat similar options with respect to how they support charities.

In our past research, we highlighted that the charitable sector is extremely dependent upon government grants and funding. For example, registered charities in 2003 obtained 54 per cent of their revenues from government sources, while 28 came from fees, investment income and other income, leaving a mere 18 per cent from donations and gifts. This led us to the conclusion that increased generosity was called for.

While that sentiment remains unchanged, there is another way of looking at the breakdown of revenues.

Since government funding is a transfer of tax dollars collected from Canadians, we could view this as indirect charitable giving. This perspective has some appeal in our representative democratic political system. Canadians elect officials whom they believe best reflect their own opinions and values. Once elected, the theory is that those officials will pursue policies that “represent” the wishes of the majority. For example, Canadians have time and again reported in surveys that additional funding for health care is their primary social concern, so the federal and provincial governments have transferred additional financial resources to the public health care system in recent years. The implication is that Canadians are willing to pay relatively high taxes in order to receive certain services, a large portion of which comes from the non-profit sector, which includes many charities. Having said that, it should be noted that there is no option to opt out from this indirect charitable giving, as the payment of taxes is mandatory. But, this does not mean that Canadians lack options.

Advantages to self-directed giving

If an individual chooses to make a donation directly to a registered charity, he or she will receive a tax credit. Since this transfers a portion of the funds available for charitable giving from the government to the individual, we could view this as a shift towards self-directed giving and a shift away from managed giving through the government.

Direct giving offers several advantages. First, the individual can personally select the charity that will receive the funds. Second, there is a possible increase in efficiency, since the intermediary cost of the government bureaucracy is avoided. Third, since government taxes are used to fund a variety of activities, with the financing of charities being only a small part of outlays, the use of tax credits for personal donations can lead to a net increase in the funds made available to the charitable sector.

This is not to say that government funding of charities is undesirable. As stated earlier, many charities are utterly dependent upon government support. The point is simply that there are several factors to recommend personal donations as well.

Having said that, it should be acknowledged that the act of personal giving does require a net additional financial contribution. For every dollar donated in excess of $200, an individual receives a tax federal and provincial tax credit equal to 45 cents. This means that there is a net 55 cent increase in the financial outlay from the pocket of the giver. However, this additional generosity is badly needed. As we argued last year, charities must receive greater financial support in the future, or they will have more difficulty in providing the social services that Canadians have come to take for granted. The additional funding can come either from the government or directly from Canadians, and the current dependence on government grants makes us favour an increase personal giving. Moreover, the act of personal giving provides a greater degree of financing to the charitable sector.

Strategic philanthropy is the name of the game

The bottom line is that Canadians can be more effective in their philanthropic efforts if they treat them as investments. Indeed, many wealthy individuals have applied their business and investment acumen to their charitable giving with considerable success. Bill Gates, Warren Buffet and many other billionaires have shared their wealth, while pursuing a strategic approach to philanthropy in order to ensure that their money is well spent. However, one doesn’t need to be a business tycoon to have the same success on a smaller scale.

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