

Income tax amendments affect charities

By Terrance S. Carter
and Theresa L.M. Man

Draft income tax amendments implementing the 2004 Federal Budget were released on Sept. 16, 2004, and further amended and consolidated by a *Notice of Ways and Means Motion* tabled on Dec. 6, 2004 (the "December 2004 Amendments").

The resulting Bill C-33, *A Second Act to Implement Certain Provisions of the Budget Tabled in Parliament on March 23, 2004*, was passed by Parliament on February 25, 2005, and received first

reading by the Senate on March 7, 2005. These amendments, summarized below, generally apply to taxation years beginning after March 22, 2004, with some exceptions being in effect 30 days after Bill C-33 receives Royal Assent, and do not affect the changes embodied in the February 2004 Amendments.

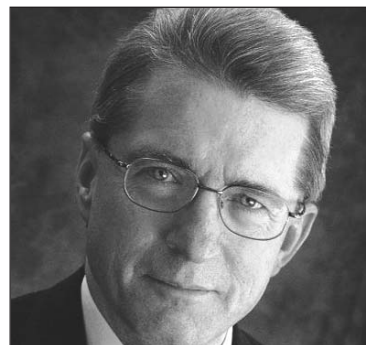
New intermediate sanctions

Intermediate sanctions will be introduced to provide an alternative to revocation of charitable status for minor or unintended infractions, including taxation of gross revenue derived from busi-

ness activities, suspension of tax-receipting privileges, monetary penalties, and taxation of gifts and transfers to other registered charities. Some sanctions are progressive, increasing in severity for repeat infractions within a five-year period.

Annulment and revocation

The minister will now have explicit authority to annul an organization's registration if it was registered in error or if it has ceased to be a charity "solely as a result of a change in law." Annulled organizations will be deemed not to have



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been registered at all and the Part V revocation tax will not apply, but official receipts issued prior to annulment will be accepted as valid. The minister also retains the right to revoke the registration of a

charity in the event of severe breaches of the *Income Tax Act* ("ITA"). These amendments also require the assets of a charity whose registration has been revoked to be transferred to an "eligible donee", rather than a qualified donee.

Appeals

The appeal process will be more accessible and affordable for registered charities and unsuccessful applicants for charitable status. Canada Revenue Agency's ("CRA") internal review process will be extended to notices of a decision by the minister regarding the revocation or annulment of a charity's registration, designation of a charity as a private or public foundation or charitable organization, denial of applications for charitable status, and imposition of taxes or penalties against a registered charity. Appeals of decisions concerning refusals to grant registered charitable status and revocation of registered charitable status will continue to be made to the Federal Court of Appeal, while taxes and penalties will be appealed to the Tax Court of Canada.

Transparency and accessibility of information

The minister will have the authority to release additional information to the public, including grounds for revocation or annulment; financial statements; decisions of CRA regarding notices of objection; identification of registered charities subject to sanctions, the type of sanction imposed, and grounds for the sanction; information to support an application by a registered charity for special status or an exemption under the ITA; and reasons for denying the registration of organizations. Further, official donation receipts issued after 2004 will be required to include the current Internet address of CRA.

New disbursement quota rules

The 4.5 per cent disbursement quota will be reduced to a more manageable rate of 3.5 per cent for taxation years beginning after March 22, 2004. The 3.5 per cent disbursement quota, previously only applicable to public and private foundations, will also apply to charitable organizations, if the value of their investment assets exceeds \$25,000.

see CHARITY p. 12



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CORPORATE COMMERCIAL LAW

SCC rules on damages for contract with multiple modes of performance

By Nicholas Kluge
and Vimal Kotecha

In the recent decision of *Hamilton v. Open Window Bakery Limited* [2004] 1 S.C.R. 303, the SCC sought to clarify the principles governing damage calculations in actions involving contracts with multiple modes of performance. The court ruled that where a contract can be performed in several ways, damages should be calculated in the way that is least profitable to the plaintiff and least burdensome to the defendant.

Under the terms of an employment contract, the defendant Open Window could terminate the ser-

vices of the plaintiff Hamilton: (1) for cause, without notice at any time if one party acted in a manner detrimental to the well being of the other party; or (2) by using an unconditional right of termination on three months' notice any time after the start of the 19th month of the contract.

Acting under the belief that Hamilton deliberately misrepresented the ingredients in bagels to be shipped to Japan, in order to deceive Japanese customs officers, Open Window purported to terminate Hamilton for cause. Subsequently, after the 19th month of the contract, they again purported to

terminate Hamilton under the contract's unconditional termination provision.

The trial judge found the first termination had been without legal cause, and that if Open Window had known the true state of affairs or bothered to conduct a full investigation into the actions of Hamilton it would likely not have sought to terminate Hamilton but let the contract run its course. On this basis, damages were awarded for the full contract term, less a 25 per cent contingency for the possibility that the contract would have been terminated early for other reasons. In essence the plaintiff was compensated on the basis that she would have completed the contract but for the termination.

The Ontario Court of Appeal reduced the damages award, stating that the plaintiff was entitled only to damages for the minimum performance required of the defendant. This judgment was upheld on further appeal to the Supreme Court of Canada, which stated the proper damages calculation formula where a contract has more than one method of performance as follows: "... Generally speaking, where there are several ways in which the contract might be performed, that mode is adopted which is the least profitable to the plaintiff, and the least burdensome to the defendant."

The court went on to state, however, that: "The method of performance that is most advantageous or least costly for the defendant may not always be clear at the outset from the contract's terms. A court may have to consider evidence to determine an estimated cost of the various means of per-

formance."

This statement undermines the seductive simplicity of the "least profitable to plaintiff" formulation. In this case (as was pointed out in a dissenting judgment at the court of Appeal) the trial judge had found as a fact that Open Window would have continued the contract to termination subject to the possibility (assessed at 25 per cent) of early termination for other reasons. The trial judge had, essentially, gone through exactly the exercise contemplated by the Supreme Court.

Generally speaking, the object of an assessment of damages, whether due to a breach of contract law or tort, where a party sustains a loss, is to put the party complaining in the position that they would have been occupied if the wrong had not occurred, or in the position they would have enjoyed if the contract had been fulfilled.

In the case of losses compensable due to a tort, it is widely recognized that the analysis of the plaintiff's interest is to be put in a similar position if the tort had not

term not of the contract but of the termination period only. This concept is easily followed where the term of the contract is well defined and where an early termination clause within the contract is clearly defined.

However the conclusions as to the method of quantification of damages established by the Open Window case do not clearly address the circumstances where:

- no contract exists between the parties;
- a termination clause does not exist within the contract or where the termination clause is not reflective of a reasonable notice period;
- there has been a long history and frequent renewals of the existing contract;
- the duration of the contract is based on specific performance rather than time, or
- the termination of such a contract is dependent on an event not under the control of either party.

In any of the above circumstances an analysis of the quantum of damages must be evaluated on a case by case basis. As stated by the court, "In some cases it will only be after this factual investigation that a court can confidently conclude that a cer-

tain mode of performance would have been the least burdensome for the defendant."

Clearly the quantum of damages pursuant to a breach of contract or a tort for that matter may not be as simple as described by the cited case. One must evaluate the quantum of loss, if any, depending on the specific circumstances of the relationship between the parties.

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"In some cases it will only be after this factual investigation that a court can confidently conclude that a certain mode of performance would have been the least burdensome for the defendant."

occurred (restitution and reliance interests).

In the case of a breach of contract, Canadian and U.S. courts have generally taken the approach that where there are several ways in which the contract might be performed, that mode is adopted which is least profitable to the plaintiff and the least burdensome to the defendant. The belief is that the plaintiff should not be rewarded due to a termination of the contract, but should be put in a similar place if the contract had continued (expectation interests). In the case of a contract with an early termination clause, at the option of the breaching party, the cited case argues that the losses, if any, should be restricted to the

Compliance may be difficult

CHARITY

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In addition, a new concept of "enduring property" was introduced, which includes gifts received by way of a bequest or inheritance (including gifts of life insurance proceeds, RRIFs and RRSFs as a result of direct beneficiary designation), 10-year gifts, and gifts received by a charity as the transferee of an enduring property. In general, a charity will be permitted to encroach on the capital gains of enduring property up to a maximum of the lesser of 3.5 per cent of the charity's investment

assets and its "capital gains pool", which is the realized capital gain from the disposition of enduring property declared by the charity on its T3010 Information Return.

Finally, transfers from registered charities to charitable organizations, previously exempt from the 80 per cent disbursement quota, will be subject to the 80 per cent disbursement requirement, except those involving specified gifts and enduring property.

While many aspects of the proposed new disbursement quota rules reflect an attempt by the Department of Finance to address a number of difficulties facing

charities, the complexities introduced are such as to make them more difficult, if not impossible, for the average charity to understand, let alone comply with. In addition, there are concerns that the proposed amendments represent a major change in tax policy that will blur the line between public foundations and charitable organizations.

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