FOCUS

ON WILLS, ESTATES, CHARITIES, & TRUST

Revenue agency gets tough with charities

BAHAR NASIRZADEH FOR THE LAWYERS WEEKLY

The Canada Revenue Agency has a mandate to carefully scrutinize tax shelter schemes involving charities.

KAREN COOPER

The Canada Revenue Agency is cracking down on donation tax shelters.

As part of its get-tough act the Canada Revenue Agency (CRA) issued a notice of suspension to the International Charity Association Network (ICAN), a registered charity under the *Income Tax Act* (ITA) for a one-year period commencing Nov. 28, 2007. During this period, ICAN is prohibited from issuing official income tax receipts for donations made to it, but has not been precluded from carrying out its charitable activities.

This was the first sanction of this sort imposed by CRA since Parliament passed legislation in 2005 implementing new rules concerning the taxation and administration of charities, including new intermediate sanctions.

CRA has since issued a second notice of suspension, this time to Adath Israel Congregation ("Adath") in Montreal for a one-year period commencing March 19, as well as levied a penalty of $499,055 against Adath. This appears to be the first imposed under the new intermediate sanctions.

Both situations highlight compliance issues for all registered charities not fulfilling the extensive reporting requirements outlined in the ITA, as well as setting the framework for interlocutory applications relating to the intermediate sanctions.

ICAN applied to the Tax Court of Canada for a postponement of the suspension (*International Charity Association Network v. Canada*, [2008] F.C.J. 500). In its affidavit, CRA stated that it was concerned by ICAN's participation in donation tax shelters, which had resulted in a significant increase of total revenue during this period — from $528,000 in 2001 to $314 million in 2005. CRA's concerns also related to the valuation and existence of gifts in kind, which comprised the majority of ICAN's donations, and whether ICAN actually received the goods for which it issued income tax receipts.

> **Both decisions highlight compliance issues for all registered charities...**

In dismissing the application, the court noted that if the suspension were postponed, CRA would be "handcuffed" in its ability to administer the charities provisions of the ITA, to ensure compliance and to protect the public interest.

This is the first decision with respect to the application of the new intermediate sanctions and the Tax Court of Canada's first foray into the regulation of charities. The decision establishes that, from the Tax Court of Canada's perspective, the test for applications pursuant to subs. 188.2(4) and (5) is the same as that for seeking injunctive relief.

The threshold for the first part of the test – whether a serious issue is to be tried – seems to have been set fairly low and was easily satisfied by the applicant in this instance. The application of the second part of the test – irreparable harm to the charity – indicates that the court will be looking for corroborating evidence from the charity to support any claim of irreparable harm.

Finally, it appears that the third part of the test – balance of convenience – will generally favour CRA, given its role in regulating charities and protecting the public interest. The decision also highlights the importance of maintaining ade-

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New law shields RRSPs from seizure

DANIEL FRAJMAN

Recent federal legislation amending the *Bankruptcy and Insolvency Act* (BIA) seems set to make unseizable and exempt from execution all registered retirement savings plans (RRSPs), registered retirement income funds (RRIFs), and other similar registered savings plans, including self-directed plans.

The new rules have not yet come into force, but will do so on proclamation by the federal government. This may occur by the end of 2008 when regulations to the legislation have been drafted.

There is a "look back" provision in these new rules allowing creditors to reverse contributions made to the registered plan up to 12 months prior to the bankruptcy of the plan's owner. The rules would apply across Canada to bankruptcies occurring after the rules come into force. However, provincial laws that might provide greater protection to the owner through exemptions from seizure or execution will continue to apply and have precedence over these new rules.

Existing law

The existing law in most provinces, including Quebec and Ontario, does not usually shield self-directed RRSPs from seizure or execution.

Most self-directed RRSPs issued by the major financial institutions are set up through a declaration of trust pursuant to which the owner contributes funds and makes investment decisions relating to an account opened though the financial institution and its captive trust company. In the leading case of *Bank of Nova Scotia v. Thibault*, [2004] 1 S.C.R. 758, the Supreme Court of Canada dismissed the possibility of unseizability in such circumstances.

With respect to purported unseizability of RRSP assets held on trust, the Supreme Court wrote, "The trust argument is, to a certain extent, a mirage. The [property on trust] may not be seized to pay the debts of the settler or of the beneficiary because the property does not belong to them. However, the patrimonial rights of the beneficiary or of the settler under the trust contract, like any personal patrimonial right, are seizable."

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WILLS, ESTATES, CHARITIES, & TRUST

Trust structure poses perplexing problems for businesses

Trusts are now common commercial entities

MARGARET NELLIGAN

In today's business environment, the parties involved in commercial transactions are often not simple business corporations. Instead, businesses use a variety of entities to carry out the transaction — limited partnerships, trusts, general partnerships, statutory corporations and foreign corporations. Each entity has its own legal nature which will determine the approach an opinion giver must take when providing opinions regarding the transaction. Trusts, which are now common commercial entities, create some tricky issues.

A perplexing problem arises when dealing with opinions regarding the power and capacity of trusts. A trust is not a separate legal person and has no power or capacity, in and of itself, to contract. The law regards only individuals and corporations as distinct personalities.

How then does counsel provide opinions on the power and capacity or the legality and enforceability of a contract entered into by a trust which does not have a distinct legal personality?

Unlike a corporation, which has the powers of a natural person, the powers of trustees to act on behalf of a trust are conferred only by the trust declaration. An examination of the trust declaration will determine whether the trustees have the power to enter into the contract in question.

> "A trust is not a separate legal person and has no capacity, in and of itself, to contract.

The trustees of the trust are the legal persons who enter into contracts on behalf of the trust. The opinion, therefore, is really with respect to the trustee's capacity and powers and should be framed that way. A form of power and capacity opinion for a trust could state: "Pursuant to the Trust Declaration, the trustees of the Trust have all requisite power, capacity and authority under the laws of the Province of Ontario to carry on the business of the Trust, to own or lease the properties and assets of the Trust and to carry out the transactions contemplated by the Agreement."

A further issue arises in connection with the form of enforceability opinion in respect of a trust. As we know, a trust acts through its trustees. If an action is brought to enforce a contract against a trust, it is brought against the trustees. The question then arises as to how the trustee will satisfy a judgment brought against it as trustee.

At common law, the trustee is entitled to be indemnified out the assets of the trust in respect of liabilities incurred by the trustee in the course of carrying out its duties. The logical conclusion is that the trustee can satisfy any action for enforcement through its rights of indemnification. However, there are limits to those rights of indemnification, particularly in circumstances of breach of trust. Also, a breach of trust may restrict the trustee's rights of indemnification, even if the breach of trust is unrelated to the indemnification sought.

Some practitioners request an opinion which states not only that a particular agreement is enforceable against the trustees, in their capacity as trustees of the trust, but also that the agreement is "enforceable against the assets of the trust." Many practitioners will give this opinion without qualification based on confidence that the courts will recognize the income trust as a modern commercial vehicle similar to a corporation and permit enforcement against the assets notwithstanding the common law limits on indemnification.

Other practitioners however include the following qualification: "The ability of a person to enforce the Agreement is subject to the Trustee's right to indemnification and is subject to any limitations on such rights arising out of (i) any breach of trust by the Trustee or (ii) any other claims of the beneficiaries of the Trust against the Trustee."

This is a thorny issue which will not be resolved through the negotiation of a legal opinion. Until there is some judicial recognition that a business income trust should be considered differently from an ordinary trust, a qualification would seem to be appropriate. However, that is not always the view of the bank's counsel who often insist on difficult opinions.

Most business income trusts have an underlying corporation or limited partnership which will enter into most business contracts. Therefore, the issue does not arise in every income trust opinion. Further, the issue also does not arise in the circumstances of secured lending, where the rights of creditors to pursue the assets is clearly set out by statute. Provided the trustees have the power to give security on the assets of the trust, there is no issue with respect to enforcement.

Another interesting issue arises in connection with trusts under s. 18 of the *Mortgages Act (Ontario)* and s.10 of the *Interest Act (Canada)*. Under both of these statutes, the statutory right of prepayment after five years is

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Court showed deference to agency

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quate books and records, and notes that CRA is entitled access to invoices, receipts, vouchers, valuation reports, and any other documents that permit CRA to verify a charity's income and disbursements.

Unfortunately for ICAN, on Dec. 3, 2007, CRA issued a notice of intention to revoke ICAN's charitable registration. ICAN sought a deferment of the publication of the notice of revocation in order to allow it time to challenge the revocation through an application to the Federal Court of Appeal.

On April 2, the Federal Court of Appeal dismissed this motion, because a review of the record disclosed "no basis for concluding that ICAN will suffer irreparable harm from the loss of receipting privileges after the termination of the Minister's suspension." The court further stated that had a basis for irreparable harm been found, the balance of convenience would still favour the minister, as it was reasonable to attempt to safeguard the integrity of the charitable sector by "carefully scrutinizing tax shelter schemes involving charitable donations of property and, where there are reasonable grounds to believe that the property has been overvalued, by taking appropriate corrective action."

> "The amount of the penalty is 125 percent of the amount of the receipts determined by CRA to be false.

In the case of Adath, in addition to suspending its ability to issue receipts, CRA also imposed a monetary penalty of $499,055 on the basis that certain donation receipts issued by Adath contained false information. It appears from CRA documents that the main concern related to receipts issued for burial plots and attendance at a synagogue-run nursery. The amount of the penalty is 125 percent of the amount of the receipts determined by CRA to be false. At this point, there is no public indication from CRA as to whether it will immediately seek revocation of Adath's charitable status, as in the case of ICAN.

The court's handling of the ICAN situation is an early indication of substantial deference to CRA's judgement in donation tax shelter matters. Both situations highlight the importance of ensuring that charities comply with their obligations under the ITA with respect to record-keeping and receipting — the consequences of a failure to comply can be very serious. ■

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