

CHARITIES/ NOT-FOR-PROFIT LAW

RECENT DEVELOPMENTS OF IMPORTANCE

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The charitable sector in Canada has again seen a number of important regulatory and common law developments over the past 12 months at both the federal and provincial level that will have a significant impact on how charities operate in Canada and abroad.

This summary is intended to provide a brief overview of some of the more important of these recent developments, including changes to the *Income Tax Act*¹ (*ITA*), new guidance, commentaries and other publications from the Charities Directorate of the Canada Revenue Agency (CRA), technical interpretations from CRA, court decisions, as well as other federal and provincial initiatives affecting charities.

RECENT LEGISLATIVE INITIATIVES UNDER THE INCOME TAX ACT

2009 Federal Budget²

Although there has been much activity from CRA over the past year concerning the administration of charities, the 2009 Federal Budget, released on January 27, 2009, was noticeably devoid of any significant legislative developments concerning the regulation of charities with regard to either tax incentives or technical amendments. The exception to this were a few minor amendments with regard to refining provisions concerning the excess business holding rules for private foundations.³

Unfortunately, the budget did not provide any direct mechanism to encourage charitable donations through enhanced tax-measures. The charitable sector had been hoping for tax incentives, such as enhanced tax credits, but ended up with only a few sector specific government grants and contributions. Specifically, the budget provided a targeted, two-year fund of \$60 million to support infrastructure-related costs for local and community cultural and heritage institutions.

Possible Disbursement Quota Reform⁴

In an attempt to motivate discussions concerning an alternative regime to the confusion surrounding the current disbursement quota calculation, the Charity and Not-For-Profit Law Section of the Canadian Bar Association submitted a concept paper to the Department of Finance on July 20, 2009, as part of a submission regarding the upcoming 2010 Federal Budget. While the regulatory objectives of ensuring that current gifts are disbursed and that charities do not accumulate income or defer capital gains forever are important, the arbitrary 80 per cent and 3.5 per cent disbursement quotas are not efficient means of ensuring that the maximum amount of resources go towards the charitable purposes and activities of charities. The concept paper suggests that the reform of the disbursement quota regime should attempt to better pursue these policy objectives, respect donor restrictions on gifts, allow more flexibility in the timing of expenditures and investment strategies for charities and aim at regulatory simplicity with regard to compliance.

NEW GUIDANCE, COMMENTARIES AND OTHER PUBLICATIONS FROM THE CANADA REVENUE AGENCY

3.5 per cent Disbursement Quota Extended to All Charitable Organizations⁵

On November 28, 2008, CRA published a reminder to the charitable sector that for the fiscal period beginning on or after January 1, 2009, the 3.5 per cent disbursement quota is to apply to charitable organizations registered before March 23, 2004. Charitable foundations (both public and private) and charitable organizations registered after March 22, 2004, were already subject to the 3.5 per cent disbursement quota.

The calculation of the 3.5 per cent disbursement quota is based on the average value of property owned by the charity, which was not used directly in charitable activities or administration, in the 24 months before the beginning of the fiscal period in question.⁶ For charitable organizations registered before March 23, 2004, they must know that value for 2007 and 2008 when calculating the 3.5 per cent disbursement quota for the 2009 fiscal year. However, if the average value of the charity's property not used for charitable activities or administration is \$25,000 or less, the charity does not have to calculate the 3.5 per cent disbursement quota.

Introduction of New T3010B Annual Information Return

On February 20, 2009, CRA released online the new form T3010B, which is the new annual information return for registered charities that is to be used for fiscal periods ending on or after January 1, 2009. The new T3010B form is CRA's response to many requests from registered charities to simplify the information return and reduce the filing burden for small charities that may have limited resources for addressing administrative requirements. While the new form is anticipated to generally benefit smaller charities, the form is also designed to require additional information from larger charities, which will likely be filling in more information than they did in the previous form.

CRA Introduces Anti-Terrorism Checklist⁷

On March 29, 2009, CRA released its long-awaited Checklist for Charities on Avoiding Terrorist Abuse (Checklist),⁸ a checklist that is intended to help Canadian charities identify vulnerabilities to terrorist abuse and develop good management practices. CRA indicates that the checklist is based on international and domestic concerns,

experience and guidance, and is not meant to be a comprehensive guide. While the introduction of the checklist is certainly a step in the right direction in recognizing the need to provide guidance to the Canadian charitable sector, a review of the checklist suggests that CRA may not have gone far enough in providing the necessary practical guidance. Canadian charities deserve comprehensive guidelines and guidance from CRA that does not force the charity to reconcile multiple international standards in order to comply with Canadian anti-terrorism legislation in a vacuum.

CRA Releases Policy Commentary on Requests for Disbursement Quota Relief

On April 6, 2009, CRA released a policy commentary (CPC-029) regarding requests for disbursement quota relief.⁹ Subsection 149.1(5) of the *ITA* states that a charity may apply for relief from its disbursement quota requirements. If granted, the relief would be applicable to the particular tax year only.

In deciding whether or not to grant relief, CRA will require confirmation that the charity: is not in a shortfall situation simply because of a miscalculation of its disbursement quota; has no available excesses; has disbursed all available income; and is doing everything in its power to meet its disbursement quota, such as drawing upon unrestricted funds to meet the quota.

Clarification by CRA on Enduring Property for Purposes of the Disbursement Quota¹⁰

On April 20, 2009, CRA released a document entitled "Treatment of Enduring Property for Purposes of the Disbursement Quota"¹¹ setting out answers to nine frequently asked questions on this issue. The term "enduring property" (*i.e.*, 10 year gifts, bequests, testamentary gifts of RRSPs and life insurance, and inter-charity transfers of such property, and five year inter-charity gifts to charitable organizations are all excluded from the 80 per cent disbursement quota) was introduced in the 2004 Federal Budget (which became law in 2005) and has had a substantial impact on the calculation of the disbursement quota of charities and the ability of charities to encroach on ten-year gifts to meet its 3.5 per cent disbursement quota.¹² Since the introduction of this term and other related rules on the disbursement quota, there have been many questions that the charitable sector has raised concerning the treatment of enduring property for disbursement quota purposes, which CRA attempted to answer in this document.

CRA Releases a Policy and Guidance on Sports and Charitable Registration

On April 30, 2009, CRA released a revised Summary Policy on Sport (CSP-S14),¹³ which outlines the requirements for charities engaged in sports to be eligible for charitable status, emphasizing that the promotion of sports is not recognized as being inherently charitable and therefore such organizations must demonstrate how sports carries out their charitable purposes. CRA also released its final form of Guidance on Sports and Charitable Registration (CPS-027)¹⁴ on April 30, 2009, which provides further discussion on how those requirements might be achieved. The Guidance will be of particular interest to religious charities that conduct sports activities because it specifically states that it must be clear that the sport element of a charity's activities is not a "collateral non-charitable purpose."

CRA Proposed Guidance on the Protection of Human Rights and Charitable Registration¹⁵

On May 8, 2009, CRA released a draft policy document entitled *Consultation on proposed Guidance on the Protection of Human*

*Rights and Charitable Registration.*¹⁶ The purpose of the draft Guidance is to provide guidelines for determining whether or not an organization that is established to protect human rights can be registered as a charity under the *ITA*. As such, the draft Guidance will be highly relevant to human rights organizations that are considering charitable registration and existing charities that engage in the protection of human rights. In general terms, organizations that are seeking to become registered charities must have purposes that are considered, at law, to be charitable and for the benefit of the public. The "protection of human rights" is defined in the draft Guidance as "activities that seek to encourage, support, and uphold human rights that have been secured by law, internationally or domestically." It is expressly stated that the protection of human rights does not include advocacy for new legal rights at any level, both nationally and internationally.

CRA's New Guidance on Fundraising¹⁷

On June 11, 2009, CRA released its much anticipated Guidance (CPS-028): *Fundraising by Registered Charities (Fundraising Guidance)*.¹⁸ The Fundraising Guidance, which includes an additional 23 page document to elaborate on the Guidance, replaces CRA's previous policy on fundraising (CPS-001) entitled "Applicants that are Established to Hold Periodic Fundraisers." CRA previously released draft versions of the Fundraising Guidance and additional information entitled "Consultation on Proposed Policy on Fundraising by Registered Charities" and "Background information for Proposed Policy on Fundraising by Registered Charities" in March and June of 2008, respectively.

While the Fundraising Guidance is clearly a marked improvement over the proposed policy, it will likely prove to be a challenging document for charities and their lawyers and professional accountants to work with. As a result, it may take the charitable sector some time to fully comprehend its implications. Given that the Fundraising Guidance is only intended to constitute a clarification of CRA's existing position on fundraising, the Fundraising Guidance will apply to audits related to both future and past years.

CRA's Proposed New Guidance for Charities Operating Outside Canada¹⁹

On June 30, 2009, CRA released a draft consultation paper entitled "Consultation on the Proposed Guidance on Activities Outside of Canada for Canadian Registered Charities".²⁰ The proposed Guidance is intended to apply to all activities carried on through intermediaries both outside and within Canada, notwithstanding that the name of the proposed Guidance would suggest otherwise. Highlights of the proposed Guidance include an exception to the requirement for a formal written agreement where the amount disbursed is below a certain threshold, a concrete list of "measures of control" which clarifies CRA's expectations for a charity operating through an intermediary, clarification of compliance with local laws, and elaboration of the forms of intermediary relationship.

The proposed Guidance, however, has challenging aspects to it, such as the burdensome requirement that an intermediary produce receipts, invoices and vouchers at the end of a charitable program, even when the charitable program involves utilization of third party contractors. In addition, the "own activities" requirement imposed by CRA unduly restricts Canadian charities' ability to participate in charitable activities overseas. As well, the requirement that books and records be kept in Canada is particularly onerous when the information required by CRA to

determine compliance is normally readily available through electronic records

CRA Webpages on Specified Gift and 10-year Gift

On December 2, 2009, CRA released two new webpages to clarify the meaning of specified gift and 10-year gift.²¹ CRA explains that a specified gift is a type of inter-charity gift that may affect their disbursement quota requirements. In relation to 10-year gifts, CRA explains that a 10-year gift is a donation made to a registered charity that is subject to a donor's written trust or direction that the gift, or any property substituted for it, be held by the recipient charity, or another registered charity (if the gift is transferred) for 10 years or more from the date the gift was made.

The webpage regarding 10-year gifts is useful because the webpage sets out sample language for a 10-year gift direction and permission to encroach on the capital for the purpose of meeting the charity's disbursement quota. However, the treatment of 10-year gifts for disbursement quota purposes is much more complicated than the simplified explanation contained on this webpage and it is a concern that the reader may not be aware of the complexities involved and therefore may be misled as a result of the simplified explanation on this webpage.

CRA Provides Instructions on Avoiding Improper Receipting

On December 21, 2009, CRA released Registered Charity Newsletter No. 23²², which provides information on proper receipting procedures for registered charities. CRA reminds charities that the ability to provide official donation receipts is a significant tax privilege granted to registered charities and therefore comes with substantial responsibility. In this regard, CRA notes that improper receipting practices can occur where receipts are issued: with inaccurate or missing information; for transactions that do not qualify as a gift; on behalf of another organization; or for an inflated amount. In this Newsletter, CRA sets out a non-exhaustive list of good governance practices a charity could adopt to prevent improper receipts being issued. CRA reminds charities that the issuance of donation receipts is central to ensuring that Canadians continue to have confidence when giving to charities.

RECENT TECHNICAL INTERPRETATIONS AND COURT DECISIONS UNDER THE *INCOME TAX ACT*

Gifts of Marketable Securities – Enduring Property?

In a technical interpretation dated January 15, 2009, (CRA document #2008-0268731E5), CRA considered whether the donation of marketable securities to a registered charity may be characterized as a gift of enduring property and, if so, would the charity be prevented from disposing of the marketable securities and maintaining the substitute property as enduring property (i.e., 10 year gifts, bequests, testamentary gifts of RRSPs and life insurance, and inter-charity transfers of such property, as well as five year inter-charity gifts to charitable organizations are all excluded from the 80 per cent disbursement quota). CRA confirmed that gifts of marketable securities will qualify as enduring property if the donor provides written direction at the time of the donation that the securities are to be held by the charity for ten years or longer. Provided that the donor has given the charity permission to dispose of the securities within the 10-year period, property later substituted for the original securities will also be considered enduring property. Charities receiving gifts of marketable securities should ensure that donors include the permission to substitute property at the time of the donation.

Gift of Capital Property by Will

In a technical interpretation dated February 4, 2009, regarding gifts of capital property by will (CRA document # 2008-027364), CRA confirmed that proposed subsections 118.1(5.4) and (6) of the *ITA* as contained in an earlier version of *Bill C-10* will override the application of paragraph 70(5)(a) of the *ITA*. Proposed subsections 118.1(5.4) and (6) of the *ITA* provide that where a Canadian resident individual dies making a bequest of a capital property by will to a registered charity and the fair market value (FMV) of the capital property immediately before the individual's death exceeds its adjusted cost base (ACB), the individual's legal representative can designate in the deceased's terminal income tax return an amount between the FMV and the ACB, which will be deemed to be the individual's proceeds of disposition of the capital property and, for the purpose of proposed subsection 248(31) of the *ITA*, the FMV of the gift. Paragraph 70(5)(a) of the *ITA* deems each capital property owned by a deceased taxpayer to have been, immediately before his or her death, disposed of by the deceased taxpayer for proceeds of disposition equal to its FMV immediately before his or her death. CRA notes that paragraph 70(5)(a) of the *ITA* is a general provision and states that it is its view that it is the amount that is designated by the legal representative pursuant to subsection 118.1(6) of the *ITA* that would be used in calculating the amount of the capital gain arising on the deemed disposition of the gifted property to be included in the individual's final return.

Directed Gift to Municipality

In a technical interpretation, dated March 16, 2009 (CRA document #2008-030447), CRA considered whether a municipality could issue donation receipts in circumstances where a gift received by the municipality is directed by the donor to a separate non-profit organization. The non-profit organization was responsible for the maintenance of a building on a site owned by the municipality and to which it had been delegated the operation of several municipal programs. CRA indicated that a municipality in Canada is a "qualified donee" and the municipality may issue an official tax receipt for the eligible amount of the gift. Further, CRA indicated that donations can be receipted by a municipality in Canada on behalf of an organization which operates under the authority of the municipality (e.g., a committee established by a municipal bylaw), provided the municipality retains discretion concerning how the donated funds are to be spent. If the municipality is merely collecting funds from donors on behalf of the non-profit organization which is entitled to the property so transferred, the municipality would not be in receipt of a gift and could not issue a donation receipt.

CRA Withdraws Compliance Agreement

In the May 20, 2009, decision of *Christ Apostolic Church of God Mission International v. Canada (Minister of National Revenue)*,²³ the Federal Court of Appeal held that CRA could withdraw a compliance agreement it had made with the organization in the course of an audit of its charitable status. In general, compliance agreements are agreements that are negotiated between CRA and a registered charity as a result of a charity's failure to comply with its requirements under the *ITA*. Typically, a deficiency is identified as a result of a CRA audit, and a compliance agreement provides the charity with a chance to address and correct such non-compliance. The Court's decision now provides CRA with authority to change a particular sanction from a compliance agreement, which has been signed by both CRA and a registered charity, directly to the revocation of charitable status if it so chooses. More specifically, the decision indicates that a compliance agreement can be unilaterally withdrawn by CRA and, therefore, is obviously not binding on CRA.

Tax Court of Canada Denies Leveraged Donation Tax Credit²⁴

On November 12, 2009, the Tax Court of Canada released its decision in *Maréchaux v. The Queen*.²⁵ The decision is significant because it is one of the first dealing with a leveraged donation gifting arrangement from the donor's perspective. Leveraged cash donations are one form of tax shelter gifting arrangement that has been flagged by CRA. In such arrangements, a taxpayer receives a pre-arranged loan and makes a donation of the loan proceeds plus additional cash to a registered charity. The taxpayer is not at risk for the loan and the charity must use the proceeds in a predetermined manner. CRA has issued several Taxpayer Alerts warning taxpayers that it intends to audit tax shelter gifting arrangements, including leveraged cash donations. Every such audit completed to date has resulted in a reassessment of taxes, plus interest and in some cases CRA has denied the gift completely.

OTHER FEDERAL AND PROVINCIAL INITIATIVES AFFECTING CHARITIES

Update on New Canada Not-for-profit Corporations Act²⁶

On June 23, 2009, the Canada Not-for-Profit Corporations Act (CNCA) received Royal Assent introducing a modern governance era for Canadian non-share capital corporations. Government discretion over incorporation and bureaucratic policy on both material and trivial by-law matters has been replaced by a regime more aligned with that which applies to for-profit share capital corporations, a regime that emphasizes members' rights rather than government rights and which enables not-for-profit corporations to operate as efficiently as their for-profit counterparts.

The CNCA is expected to come into force in 2011 or 2012. It will apply to every corporation incorporated under it in the future and to every corporation incorporated under Part II of the *Canada Corporations Act (CCA)* prior to that time and continued under the CNCA. Within three years of its enforcement date, all corporations incorporated under Part II of the CCA will be required to apply for a certificate of continuance in order to avoid dissolution. The application must include an officer's certificate certifying that the members have adopted a new by-law which conforms to the requirements of the CNCA. Federal not-for-profit corporations, particularly those with large membership bases, should now begin to consider the process they will follow to bring their by-laws into compliance with the CNCA.

Bill 212, Good Government Act 2009, Proposed Reforms to Legislation Concerning Charities²⁷

On December 15, 2009, *Bill 212*, the *Good Government Act*, 2009²⁸ received Royal Assent in the Ontario Legislature. *Bill 212* contains significant reforms for the charitable sector in the province of Ontario. The most important among these changes is the repeal of the *Charitable Gifts Act*²⁹, which had limited the ability of charities in Ontario to own more than a 10 per cent interest in a business. *Bill 212* also amends the *Charities Accounting Act*³⁰ so that the repeal of the *Charitable Gifts Act* extinguishes all obligations to dispose of any interest in a business that were in existence at the time of the repeal. This also applies in respect to obligations that came into existence under the *Charitable Gifts Act* at any time before its repeal. The repeal of the *Charitable Gifts Act* now allows charities to hold investments in corporations

The *Charities Accounting Act* now requires charities to report, when requested by the Ontario Public Guardian and Trustee

(OPGT), on all such investments, not just investments in for-profit corporations but also "investments" in non-share capital corporations, partnerships, trusts and "other entities." Furthermore, the investment level that triggers the reporting obligation has been reduced from one of control to generally a 20 per cent interest, determined based on direct or indirect interests, whether held alone or through one or more persons, entities or both.

Section 8 of the *Charities Accounting Act* has been repealed by the *Good Government Act*. In its place, a new section 8 has been implemented pursuant to which the positive obligations of the charity to use its land for its charitable purposes has, for all intents and purposes, been maintained, and has been expanded to apply to personal property as well as real property. In addition, the *Charities Accounting Act* placed constraints on the ability of Ontario charities to earn revenue through the use of excess land. Section 8 of that *Charities Accounting Act* formerly provided that land held by a charity that was not used for the actual use and occupation for the charitable purpose of the charity for a period in excess of three years and was not then required, or would not be required for such purposes, could be seized by the OPGT. Among the difficulties with the provision was the uncertainty that arose as to whether it was necessary for the charity itself to use its real property for its charitable purposes, or whether the act was complied with if a charity leased the land to a third party to use it for a purpose that was consistent with the charitable purposes of the charity that owned the land. The consensus among practitioners (although the conclusion was not tested by the courts) was that the property could be leased to a third party to use it for the charitable purposes of the landlord charity, but it could not be leased to simply generate ancillary income which would allow the charity landlord to meet its charitable purposes.

Other changes include an amendment to the *Accumulations Act*,³¹ which adds a section stating that the common law and statutory rules regarding accumulations do not apply and shall be deemed never to have applied to a trust created for a charitable purpose. Lastly, the *Religious Organizations' Lands Act*³² is amended to remove the 40-year term limit for which a religious organization may lease land.

Ontario Public Guardian and Trustee Releases Advice on Fundraising

The OPGT released a bulletin in July 2009 entitled "*Charitable Fundraising: Tips for Directors and Trustees*" that provides helpful information to directors and trustees of charities in Ontario on conducting charitable fundraising.³³ The OPGT reminds charities that they cannot conduct fundraising activities as a charitable purpose in their own right; charities must be open and transparent about their fundraising activities; costs are to be reasonable and accurately recorded; and directors and trustees in Ontario have a fiduciary duty with regard to their charitable assets, as well as being in compliance not only with the *ITA*, but also with the *Trustee Act*³⁴ (Ontario) and the regulations under the *Charities Accounting Act* (Ontario). Taken together with the recent CRA Guidance on Fundraising, the tips on fundraising provided by the OPGT provide a useful resource for directors and trustees in Ontario to ensure their fundraising practices are done in accordance with both federal and provincial requirements.

CONCLUDING COMMENTS

As can be seen from the above overview, the past 12 months have seen a significant number of changes with regard to the

law of charity at both the federal and provincial level. The broad extent and number of changes that have occurred during the past 12 months underscore how complicated the law pertaining to charities has become in Canada. It is therefore important for those interested in the sector to keep abreast of developments in the law as they occur. ■