WHEN IS AN ADVANTAGE NOT AN ADVANTAGE--ISSUES ARISING FROM THE PROPOSED SPLIT RECEIPTING REGIME

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1. Background

Most registered charities in Canada make great efforts to ensure that they comply with the tax and other rules applicable to them. The increasingly complex income tax rules that have been introduced over the past few years are making compliance very difficult. Among the more complex of these rules are those governing the proper treatment and receipting of charitable gifts. Both donors of substantial (or not so substantial) gifts to charities and the recipient charities are equally concerned with ensuring that their donations are appropriately and accurately receipted. Of the many changes to the income tax regime governing charities that have occurred in the last few years, the introduction of the "split-receipting" rules contained within proposed amendments to the *Income Tax Act* (Canada)[2] (the "Act") are particularly significant.

The split-receipting regime was part of a package of proposed amendments to the Act first introduced by the Department of Finance on December 20, 2002. These amendments have since undergone various incarnations on December 5, 2003 and February 27, 2004, with the latest

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[2] R.S.C. 1985, c. 1 (5th Supp.), as amended.

consolidation and amendment of the proposed regime coming with legislative amendments proposed by the Department of Finance on July 18, 2005.[3]

The explanatory notes accompanying the proposed amendments explain their purpose as follows:

> In general, these provisions are intended to reflect the policy that the amount eligible for an income tax benefit to a donor, by way of a charitable donation deduction or credit or a political contributions tax credit, should reflect the economic impact on the donor (before considering the income tax benefit) of the gift or contribution.

Subsections 248(30) to (41) have been introduced in the Act to allow a donor to receive a donation tax receipt even in situations where the donor or someone else receives a limited advantage as a result of the gift. This is referred to as "split-receipting." Some of the proposed changes in this regard also stem from the Department's intention to curtail abusive tax shelter schemes involving charitable donations. These changes generally apply to gifts made after December 20, 2002, with a few exceptions.

Although these proposed changes have not been enacted, the Canada Revenue Agency ("CRA") released *Income Tax Technical News* No. 26 on December 24, 2002, concerning proposed new rules and administrative guidelines for issuing split-receipts involving various fundraising events premised on these proposed changes, such as golf tournaments, fundraising dinners, charity auctions, lotteries, etc. Furthermore, the British Columbia Supreme Court in *Richert v. Stewards' Charitable Foundation*[4] (the *Richert* case) up-held compliance with *Technical News* No. 26, as required by the CRA in spite of the fact that the split-receipting rules have yet to be enacted as law. The appeal to the British Columbia Court of Appeal in January 2006 was dismissed.[5] In this regard, the CRA's *Registered Charities Newsletter* No. 17 specifically indicates that the proposed guidelines in *Income Tax Technical News* No. 26 "can be relied on now, despite the fact that the proposed legislation is not yet law."[6]

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[3] Canada, Department of Finance, *Legislative Proposals Relating to Income Tax* (Ottawa: July 18, 2005).
[4] [2005] B.C.C.J. No. 279.
[5] [2006] BCCA 9.
[6] Canada Revenue Agency, *Income Tax Technical News No. 26* (Ottawa: 24 December 2002).

At common law, in order to qualify as a gift, property must be transferred voluntarily with an intention to make a gift and without consideration or anticipation of benefit. Where the transferor received any form of consideration or benefit, the CRA took the position that there was a presumption that there was no intention to a make a gift. The explanatory notes to the July 2005 amendments explain that new subsection 248(30) provides the transferor with an opportunity to rebut this presumption. Specifically, subsection 248(30) provides that the existence of an advantage in respect of a property transferred to a qualified donee (e.g. a registered charity) does not "in and of itself" disqualify the transfer from being a gift under two situations, namely (a) where the amount of the advantage does not exceed 80% of the fair market value of the transferred property and (b) where the transferor establishes to the satisfaction of the Minister of National Revenue (the "Minister") that the transfer was made with the intention to make a gift. Under the latter scenario, the explanatory notes indicate that the taxpayer would need to apply to the Minister for a determination of whether the transfer was made with the intention to make a gift.

Subsection 248(31) provides that the "eligible amount" of a gift is the amount by which the fair market value of the property transferred exceeds the amount of the advantage in respect of the gift. Subsection 248(30) and (31) apply to gifts and monetary contributions made after December 20, 2002.

The explanatory notes clarify that the tax benefit available to a taxpayer, by way of a charitable donation deduction or credit, is not considered an advantage or benefit that would reflect a lack of intention to make a gift. However, the explanatory notes go on to explain that this subsection is not intended "to allow a taxpayer to profit" from the making of a gift, such as in situations where the "primary intention" of the taxpayer for "entering into a transaction or series of transactions" is to "return a profit to the taxpayer by way of a combination of tax and other benefits" so that the taxpayer is not "impoverished" by the transfer of property to the charity.

As a result of these above-proposed amendments, a number of related provisions of the Act and the *Income Tax Regulations* are also proposed to be amended, including:

(i) subsections 110.1(1) and 118.1(1) of the Act, concerning the types of gifts in respect of which an eligible amount will qualify for a deduction (for corporations) or a tax credit (for individuals);

(ii) subsections 3501(1), (1.1), and (6) and subsections 2000(1) and (6) of the *Income Tax Regulations* requiring that official donation receipts reflect the eligible amount and the amount of advantage of a gift if it is made after December 20, 2002;

(iii) subsection 149.1(1) of the Act concerning the definition of disbursement quota; and

(iv) subsection 149.1(9) of the Act concerning the deemed income of the charity if it defaults under the rules concerning the accumulation of property pursuant to subsection 149.1(8).

As a result of these new split-receipting rules, it is a requirement that the eligible amount and the amount of advantage be shown on official donation tax receipts. In anticipation of these changes, in October 2005, the CRA published a series of four sample donation receipts explaining the CRA's expectation of how split-receipts would need to be shown on official donation receipts. The CRA indicated that these are only a guide and the receipts issued by charities do not have to appear exactly as presented in these samples, but they "must contain all relevant information."[7] These samples are helpful guides for charities.

2. Implications

Generally, the introduction of the "split-receipting" regime can be seen as significant in two important ways.

First, the split-receipting rules change the definition of what constitutes a "gift" for the purposes of the Act. The second major influential aspect of the split receipting rules is that they change the calculation of the charitable tax deduction set out in section 110.1 of the Act and the charitable tax credit set out in section 118.1 of the Act.

(a) "Gift" for purposes of the Act

As stated previously, prior to these amendments, the meaning of the term gift was drawn from the definition of the term that exists at common law. According to the CRA's policy on the issue, for a gift to be included under this common law concept of the term, "no benefit of any

[7] Canada Revenue Agency, "Samples – Official Donation Receipts" (19 October 2005).

kind may be provided to the donor or anyone designated by the donor, except where the benefit is of nominal value." [8]

However, both the CRA and the courts hearing cases on this issue have not always uniformly applied this strict understanding of what constitutes a gift for income tax purposes. As John Loukidelis has commented, in some situations taxpayers have been allowed to claim deductions for gifts even though they received benefits in return, and the "principles underlying these exceptions were not always easy to discern."[9]

Although the new split-receipting rules do not introduce a statutory definition of a gift *per se*, they do introduce provisions that necessitate a broader understanding of what constitutes a gift for the purposes of the Act and therefore provide some standardization in this area. In particular, proposed subsection 248(31) of the Act introduces the statutorily defined concept of the "eligible amount of a gift":

> The eligible amount of a gift or monetary contribution is the amount by which the fair market value of the property that is the subject of the gift or monetary contribution exceeds the amount of the advantage, if any, in respect of the gift or monetary contribution.

Briefly, this definition broadens the category of what constitutes a gift under the Act to include certain transfers of property for consideration. However, as mentioned previously, there are still limits to the amount and nature of the consideration that a donor can receive for a transfer of property to constitute a gift for the purposes of the Act, and if a donor makes a donation where the advantage exceeds eighty percent of the fair market value of the property transferred and he or she cannot establish to the satisfaction of the CRA that it was with the intention of making a gift, the donation will not be considered a gift for the purposes of the Act. [10]

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[8] Canada Revenue Agency, Interpretation Bulletin, IT-110R3, "Gifts and Official Donation Receipts" (Ottawa: 20 June 1997) at para. 3.

[9] John Loukidelis, "Comments on Certain Proposed Tax Rules Applicable to Charities: Gifts to Foreign Entities, Large Gifts and 'Split Receipts'", Ontario Bar Association, *A Danger to Dabble - Charity Law Hot Spots* (October 26, 2005).

[10] Proposed subsection 248(30) states:

The existence of an amount of an advantage in respect of a transfer of property does not in and by itself disqualify the transfer from being a gift to a qualified donee if

(a) the amount of the advantage does not exceed 80% of the fair market value of the transferred property; or

In light of the introduction of these new statutory amendments, the CRA has revised its policy regarding what constitutes a gift for charitable receipting purpose. Its policy now provides:

> To qualify as a gift for purposes of the *Income Tax Act*, there must be a voluntary transfer of property, with a clearly ascertainable value, to a qualified donee. Any advantage (i.e. consideration) received or obtained by the donor in respect of the transfer must be clearly identified and its value ascertainable, and there must be a clear intent to enrich the qualified donee.[11]

(b) Calculation of charitable tax deduction/credits

The second major impact of the split receipting rules relates to the change to the calculation of the charitable tax deduction set out in section 110.1 of the Act and the charitable tax credit set out in section 118.1 of the Act. While previously both the charitable tax deduction and charitable tax credit simply reflected the fair market value of the property donated to the charity, the split-receipting regime provides for a new calculation whereby the value of the deduction or credit, as the case may be, represents the "eligible amount of the gift," which is equal to the fair market value of the property donated net of the "amount of the advantage" the donor or a person non-arm's length to the donor receives.

This new calculation, although deceptively simple, raises many questions and issues regarding its application. One such issue, which this paper will proceed to examine in more detail, is the meaning of the term "advantage." Although what constitutes the "amount of an advantage" is set out in subsection 248(32) of the proposed amendments, the statutory language is so broad in scope that it allows for a number of ambiguities that may have potentially troublesome implications. Other issues involving the complicated proposed rules to deem the fair market value of the property donated to a lesser value under certain situations are equally unclear but are outside of the scope of this paper.

(b) the transferor of the property establishes to the satisfaction of the Minister that the transfer was made with the intention to make a gift.

[11] Canada Revenue Agency, Summary Policy CSP-C13, "Consideration - Gift – Receipt" (9 June 2003).

3. Definition of "Advantage" for the Purposes of the Split-Receipting Rules

(a) Definition

As stated above, although the "amount of the advantage" in respect of a gift or monetary contribution by a taxpayer is defined within the proposed amendments of the Act, a definition of the term "advantage" is not. Although some may argue that this is a distinction without a difference, as all of the relevant split-receipting provisions refer to an "amount of the advantage" and not to an "advantage," it may be useful as a preliminary matter to consider how Canadian jurisprudence has considered what constitutes an "advantage" in other contexts.

Firstly, it can be seen that courts have appreciated the vast general scope of the term, with one judge holding that "the words 'gain advantage' could scarcely be more general in their scope."[12] Secondly, no doubt due to this fact, courts have interpreted the term broadly in diverse legal contexts. See for example, *R. v. Marsh*, a criminal matter, where the court stated:

> An 'advantage' is not confined to an economic, proprietary, or monetary advantage but the word must be interpreted in a much broader dictionary sense. 'Advantage' is defined in the Concise Oxford Dictionary as meaning, amongst other things, 'better position, precedence, superiority or favourable circumstance.[13]

This broad legal understanding of the term is reflected in the statutory definition of "amount of the advantage" in the Act, which is also large and encompassing in scope. Subsection 248(32) states:

> The amount of the advantage in respect of a gift or monetary contribution by a taxpayer is the total of:
>
> (a) the total of all amounts other than an amount referred to in paragraph (b), each of which is the value, at the time the gift or monetary contribution is made, of any property, service, compensation, use or other benefit that the taxpayer, or a person or partnership who does not deal at arm's length with the taxpayer, has received, obtained or enjoyed, or is entitled, either immediately or in the future and either absolutely or contingently, to receive, obtain or enjoy
>
> (i) that is consideration for the gift or monetary contribution,

[12] *Rozen v. R.* (1975), 28 C.R.N.S. 232 at 233 (Que.C.A.).

[13] *R. v. Marsh* (1975), 31 C.R.N.S. 232 at 237 (Ont. Co. Ct.).

(ii) that is in gratitude for the gift or monetary contribution,

(iii) that is in any other way related to the gift or monetary contribution,

(b) the limited-recourse debt, determined under sub-section 143.2(6.1), in respect of the gift or monetary contribution at the time the gift or monetary contribution is made.

Although this presents a fairly comprehensive formula for determining the proper amount of an advantage for split-receipting calculation purposes, it is also, like many other such formulae in the Act, complex and difficult to determine in practice, partly due to the sheer breadth of the definition of what constitutes an advantage for the purposes of the Act and partly due to the fact that, as the CRA has stated, "whether or not there is an advantage in respect to a donation is a matter of fact."[14]

(b) Extended legislative meaning

(i) Advantage "in respect of" what?

The amount of the advantage in respect of a gift or monetary contribution by a taxpayer is the total of …

The opening words of the definition of the "amount of the advantage" in subsection 248(32) of the Act provide that an amount of advantage "in respect of" of a gift or monetary contribution is the total obtained when the formula that follows is applied. The phrase "in respect of" has very broad connotations. Note the Supreme Court of Canada's analysis of the term in *Nowegijick v. The Queen*, where Justice Dickson held the following:

> The words "in respect of" are, in my opinion, words of the widest possible scope. They import such meanings as "in relation to", "with reference to" or "in connection with". The phrase "in respect of" is probably the widest of any expression intended to convey some connection between two related subject matters. [15]

However, as John Loukidelis has commented, in the context of subsection 248(32), the phrase "in respect of" does not serve to "define or describe the scope of the relationship that must exist between a gift and an advantage before the eligible amount of the gift will be reduced." Instead,

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[14] Canada Revenue Agency, Advance Ruling, document number 2004-0101311E5, dated November 29, 2004.

[15] [1983] 1 S.C.R. 29 at 39 and [1983] D.T.C. 5041 at 5054. (S.C.C.).

he pointed out that the scope of such a relationship is to be found in the "amount of advantage" formula that follows the "in respect of" introductory clause.[16]

The technical notes accompanying the subsection provide some guidance as to how the phrase is to apply in this context, by stating that subsection 248(32) is intended to apply "in respect of any transaction or series of transactions having either the purpose or the effect of reducing the economic impact to a donor of a gift or contribution." (*emphasis added)* Examples of such transactions are also included in the technical notes, which provide as follows:

> This includes, for instance, situations where a charity invests funds or acquires property in a manner that benefits the donor. The reduction to an eligible amount also includes an advantage that is partial consideration for, or in gratitude for, the gift or contribution, or is in any way related to the gift or contribution. An example would include the option of a donor to satisfy or pay a loan by assigning or transferring to another person a property (including the rights under an insurance policy) that has less economic value than the amount of loan outstanding. Another example would include an assumption of a donor's risk by a charity, where the acquisition, directly or indirectly, of an interest in a property of the donor by the charity may have the effect of reducing the potential loss of the donor from that investment.

These examples demonstrate that the definition of the amount of the advantage provided for in subsection 248(32) is intended to be applied widely.

(ii) What is the value of the advantage?

> *… the total of all amounts other than an amount referred to in paragraph (b), each of which is the value, at the time the gift or monetary contribution is made, of …*

The formula for determining what constitutes an "amount of the advantage" in subsection 248(32) of the Act makes reference to the "value, at the time the gift or monetary contribution is made," of any property, service, compensation, use or other benefit in question. This statutory language implies that an "amount of the advantage" must have a calculable value that is to be determined at the time that the gift is made. However, it also raises the question of how the term "value" is to be defined for the purposes of such a calculation.

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[16] Loukidelis, *supra* note 9. at p. 11.

It is interesting to note that the term "value" is used in describing the "amount of the advantage" in subsection 248(32), while the term "fair market value" is used in describing the property donated that this the subject of the gift in subsections 248(30) and (31).[17] The meaning of "value" as opposed to "fair market value" has not been definitively established in the jurisprudence.[18] However, it appears that the use of the term "value" to describe the "amount of the advantage" as opposed to "fair market value" in subsection 248(32) is designed to ensure that the CRA had a wide degree of latitude in assessing what constitutes the "value" of an "amount of the advantage" for these purposes, and to avoid any arguments in restricting the "amount of the advantage" to its "fair market value", which is potentially of a lower amount than its "value."[19]

The CRA indicated in *Technical News* No. 26 that any advantage received or obtained "must be clearly identified and its value ascertainable." It further indicates that "if its value cannot be reasonably ascertained, no charitable tax deduction or credit will be allowed."[20] As such, the CRA recommends that "in relation to valuations, the donee should consider obtaining a qualified independent valuation of the amount of the advantage." However, this view of the CRA would appear to indicate that the amount of the advantage is its "fair market value," as opposed to its "value." This throws into doubt whether what appears to be the intention of the Department is consistent with the position of the CRA.

For the purposes of the calculation of the value of the amount of advantage in subsection 248(32), the CRA indicated in its *Income Tax Technical News* No. 26[21] that it is prepared to administratively provide for a *de minimis* threshold "that will simplify matters for both donors and donees where advantages are of insignificant value."[22] The *de minimis* threshold will allow nominal value to be excluded from the "amount of the advantage" when determining the eligible amount of a gift. The *Technical News* No. 26 indicates that where "the amount of the advantage

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[17] *Ibid.* at p. 13.

[18] For an insightful discussion of this issue see Loukidelis, *supra* note 9 at p. 13-14.

[19] *Ibid.* Mr. Loukidelis observed, at p. 14, that the term "fair market value" appears to have a narrower meaning than "value" and "the Department of Finance wishes to restrict the value of a gift for the purposes of the charitable deduction, but it wishes to expand, possibly, the dollar amount that might be assigned to a benefit conferred in respect of the gift." See also *R. v. Fingold* [1997] D.T.C. 5449.

[20] Supra note 6 at 1.

[21] Supra note 6.

[22] Supra note 6, at 2.

received by the donor that does not exceed the lesser of 10% of the value of the property transferred to the charity and $75 will not be regarded as an advantage for purposes of determining the eligible amount" of the gift. This *de minimis* threshold was increased from the CRA's previous threshold of the lesser of $50 or 10% of the amount of the gift.[23] However, the CRA indicated that the revised *de minimis* threshold would not apply to cash or near cash advantages, such as redeemable gift certificates, vouchers, and coupons.[24]

It is also interesting to note that the *de minimis* threshold, as set out in the CRA's *Registered Charities Newsletter* No. 24, states that "the benefit is considered to be nominal if its fair market value does not exceed the lesser of: (a) $75.00; or (b) 10% of the amount of the fair market value of the property transferred to the charity."[25] While the *de minimis* rule will likely have little application, it is interesting to note the reference to "fair market value" as opposed to "value."

As the CRA has noted in one Advance Ruling pertaining to the provisions of subsection 248(32), the proposed amendments do not prescribe the manner for determining the value of an "amount of the advantage." Thus, although the valuation must be reasonable, in certain circumstances, more than one approach may be acceptable to determine the value of the "amount of the advantage' for the purposes of the Act.[26] This ruling is a double-edged sword; since while it provides some flexibility for charities to find appropriate methods of valuation, it provides very little guidance as to what the CRA may find acceptable on a case-by-case basis.

In addition, it is not difficult to imagine that certain fundraising events held by charities might create valuation issues. Various scenarios and examples are set out in the CRA's *Technical News* No. 26.[27] In a recent Advance Ruling, the CRA was asked to rule on the calculation of the eligible amount of a tax receipt for a "Texas Hold'um" poker fundraising tournament.[28] The

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[23] See earlier version of Canada Revenue Agency, Interpretation Bulletin IT-110R3, "Gifts and Official Donation Receipts".

[24] CRA's position on circumstances where official donation receipts for income tax purposes can be issued for gift certificates is set out in Policy Statement, CPS-018, "Donations of Gift Certificates", October 9, 2002.

[25] Canada Revenue Agency, *Registered Charities Newsletter* No. 24 (Late summer 2005).

[26] Canada Revenue Agency, Advance Ruling, document number 2003-0009195, dated November 18, 2003.

[27] Supra note 6.

[28] Canada Revenue Agency, Advance Ruling, document number 2005-0142431E5, dated April 25, 2006. It should be noted that in Ontario, this fundraising scheme (i.e. Texas Hold'um) would be unable at the present time to obtain a charitable gaming licence and therefore, if conducted by a charity, would not fall within the charitable gaming exemption of the *Criminal Code*.

provided that the amount of the eligible gift was the contribution made by the donor less: (i) the fair market value of the dinner; (ii) the fee that the donor would have had to pay to participate in a similar poker tournament (which the CRA analogized to a green fee in a fundraising golf tournament); and (iii) less a percentage amount of the prizes awarded. According to the CRA, "the total prize money divided by the number of participants would constitute an advantage that would be allocated to each participant in calculating each participant's "eligible amount" for the purposes of proposed subsection 248(31) of the Act."[29]

(iii) By what mode is the advantage to be conferred?

(A)… *any property, service, compensation, use or other benefit* …

The mode of the advantage, (i.e. that which needs to be valued), is defined broadly in subsection 248(32) to include any "property, service, compensation, use or other benefit". All of these words have broad legal and ordinary meanings in and of themselves.

The term "property" is defined in subsection 248(1) of the Act to include:

> property of any kind whatever whether real or personal or corporeal or incorporeal and, without restricting the generality of the foregoing, includes a right of any kind whatever, a share or a chose in action; unless a contrary intention is evident, money; a timber resource property; and the work in progress of a business that is a profession.

For example, in appreciation of a donation made by a donor, a charity provides a gift back to the donor. For example, in the *Richert* case,[30] in appreciation of the $1,000 donation made by the Mr. Richert, the charity provided a free coffee table book and a luncheon to the donor. The value of the book, i.e. property received by the donor, was required to be deducted from the $1,000 donation when issuing the receipt.

The terms "service" and "compensation," although not defined in the Act, also have ordinary meanings of fairly wide scope. Webster's Dictionary defines the word "service" to mean "state of being a servant; work done for and benefit conferred on another; act of kindness; … advantage; use." Webster's Dictionary defines the word "compensation" to mean "recompense; payment

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[29] *Ibid.*

[30] *Supra* note 4.

for some loss, injury etc." For example, if in appreciation of a donation, charity ABC provides a free car wash, a free house cleaning, or other valuable assistance to the donor for free, these "services" would be advantages received by the donor.

The term "use" was a recent addition to this proposed subsection of the Act in the July 2005 amendments. Before determining what the value of a use would be for the purposes of this provision, it seems appropriate to ask what exactly the use is pertaining to - i.e. what is being used? The statute doesn't provide any explicit statement, but as one author has suggested, the drafters probably intended it to apply to a use of property.[31] Again, the term "use" has a wide definitional ambit, and its inclusion in this clause suggests that the drafters may have intended to include within these provisions situations whereby donors are permitted to use facilities or properties without payment. One would assume that the value of the use in these situations would be the rental payment that would normally have been charged or owing in such circumstances.[32] It would appear that the property "used" would not be restricted to those owned by the charity in question. For example, Mr. X operates a limousine rental service and is a long-term supporter of ABC Charity. In order to induce his friend, Mr. Y, to help support ABC Charity's capital campaign, Mr. X promised to allow Mr. Y to have a one day free us of a limousine if Mr. Y makes a donation to ABC Charity. It would appear that the value of the "use" of the limousine would be the normal renal charge for the limousine.

Lastly, the term "benefit" is equally broad, and is defined in Black's dictionary to mean:

> advantage; profit; fruit; privilege; gain; interest. The receiving as the exchange for promise some performance or forbearance which promisor was not previously entitled to receive. Benefits are something to [the] advantage of, or profit to, the [the] recipient.[33]

The term "benefit" is used in a number of different contexts in the Act and has been interpreted as having a broad meaning. For example, in *R. v. Savage* in a discussion of the meaning of the phrase "benefits of any kind whatever ... received or enjoyed ... in respect of ... an office or employment," the Supreme Court of Canada held that such a benefit was not restricted to

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[31] Robert Kepes, *"Restrictions to Charitable and Political Donations" Taxation Law* 16:1 at p. 16.

[32] *Ibid.*

[33] 6th Ed. (St Paul: West Publishing Co., 1991).

remuneration paid but included any "material acquisition which confers an economic benefit on the taxpayer."[34] Moreover, in other contexts, the term has also been interpreted in a large and liberal fashion. See for example the case of *Re Spencer*, a judicial consideration of variation of trusts legislation, where the court held that "there is ample authority in the English cases….that the word 'benefit' is to be liberally interpreted and is not confined to financial benefit."[35] Due to the extremely wide scope of this word, this would appear to be a "catch all" category of advantage. For example, the invitation of a donor to a dinner event would be a "benefit," because the attendance at and enjoyment of a dinner would not be an advantage that could be a property, service, compensation or use. This was the case in the *Richert* case,[36] wherein the charity was required to deduct the value of the free luncheon provided to Mr. Richert from the $1,000 donation when issuing the receipt.

The broad scope of these terms both in and of themselves and as a collective whole imply that the drafters of subsection 248(32) intended to catch any type of advantage that could possibly accrue to a donor upon the making of a charitable gift,[37] and thus care must be taken each time a gift is made to determine whether it may run afoul of these provisions.

> (B) … *has received, obtained or enjoyed, or is entitled, either immediately or in the future and either absolutely or contingently, to receive, obtain or enjoy* …

The proposed amendments that outlined the split-receipting rules originally did not include the word "enjoyed" in this phrase, but instead remained limited to "received or obtained." The addition of the word "enjoyed" broadened the scope of application of this clause to include advantages merely "enjoyed" by the donor, to which he or she may not have had any legal right.[38] This again increases the scope of what constitutes an "advantage" for the purposes of the Act. Examples of advantages that are "enjoyed" by donors would include *inter alia* dinners, vacations, use of a rental cottage.

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[34] [1983] 2 S.C.R. 428

[35] (1969), 9 D.L.R. (3d) 74.

[36] *Supra* note 4.

[37] Loukidelis, *supra* note 9 at p. 14.

[38] The word "enjoyed" was inserted for the first time as part of the February 2004 package of proposed changes. This word is retained in the July 2005 amendments.

The clause immediately following this phrase, "either immediately or in the future and either absolutely or contingently," also increases the scope of what constitutes an "advantage" for the purposes of the Act. It lengthens the timeline during which an advantage may be received by the donor, and provides that the value of both contingent and actual advantages are to be included in the calculation of the "amount of the advantage" of a gift. This suggests that advantages that may not even accrue to the donor in the future, because of the failure of an agreed upon contingency, will still be required to be included in the calculation of the amount of the advantage at the time that the gift is made. This raises the question of how extensive this provision is intended to be - i.e. will there be situations where the contingency is so unlikely or remote that it is no longer necessary to include its value for calculation purposes? It also raises the question what if the contingent advantage did not materialized as expected? For example, Mr. X is in the process of acquiring a travel agency business and promises Mr. Y to a free world tour if Mr. Y makes a donation to ABC Charity. After Mr. Y has made a donation, after a two-year delay, the acquisition of the business did not materialize and Mr. Y did not receive the free world tour he was promised. If ABC Charity has corrected issued the donation receipt by deducting the present value of the world tour, could ABC Charity revise its receipts that was issued 2 years ago? Another example, in appreciation of a donation made, the donor's wife expects to receive a business contract from the charity to provide internet and website services to the charity. What if the contract did not materialize? This provision is so broad that it potentially catches situations which seem far-fetched and where it would be difficult if not impossible to determine the value of the "advantage."

Other than the problem of the wide scope of this provision to include remotely contingent advantage, it also involves the problem of valuating the amount of such a remote contingent advantage. This issue is reviewed in the section of this paper concerning the "timing" of the value of the advantage.

> (C)… *(i) that is in consideration for …(ii) in gratitude for …or (iii) in any other way related to the gift or monetary contribution*

It has been noted that the provisions of subsection 248(31) are so broadly drafted that they encompass any benefit of any kind and conferred at any time. The question arises as to whether the concluding words of the subsection limit its application in any way. However, a close review

of provisions in clauses (i) to (iii) above make it clear that the scope of the subsection has not been limited at all. Again, the provisions outlined in (i) to (iii) above are incredibly wide in scope.

Clause (i) refers to advantages received, obtained or enjoyed by the donor in consideration for the gift. The term "consideration" is a commonly held principle of the law of contracts which is defined in Black's Law Dictionary to mean "the inducement to a contract…where some right, interest, profit, or benefit accruing to one party, or some forbearance, detriment, loss, or responsibility, given, suffered, or undertaken by the other."[39] A number of points should be made in this regard: [40]

1. If a gift is to be made voluntarily and not as a result of a contractual obligation or for consideration, and if it is agreed that voluntariness of a gift is a fundamental element of the amendments, [41] then the word "consideration" cannot have its ordinary legal meaning.

2. However, if the word consideration is to be read consistent with its ordinary meaning, then it negates the requirement that the gift must be voluntary. That argument leads to the point that a gift can be made that lacks this voluntary aspect so long as the advantage conferred is less than eighty percent of its fair market value or where the taxpayer can show his or her intention to make a gift.

3. This raises the difficulty that a charity may be unaware of the benefit/consideration in question. Consider the following example that highlights the difficulty of the foregoing. Suppose individual X, a stranger to the charity, promises to benefit individual Y, another stranger to the charity, if he promises to donate a specified sum to the charity. X and Y enter into a legal contract establishing these terms. The charity may be uninformed as to the existence of this contract, yet it is still required pursuant to the provisions of the Act to issue a receipt that takes into account the advantage provided by X to Y pursuant to the terms of their contract.

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[39] Black's Law Dictionary, *supra* note 33.

[40] Loukidelis, *supra* note 9 at p. 16-18. Note that this section of the paper is based on Mr. Loukidelis excellent analysis of this issue, and the authors are indebted to his work.

[41] See CRA Policy, *supra* note 11 above.

Clause (ii) refers to advantages received, obtained or enjoyed as a result of an expression of gratitude or appreciation of the donor's gift. Advantages conferred in gratitude, as opposed to consideration, are not legally enforceable by the donor and therefore the use of this term again widens the scope of what must be included when calculating an "amount of advantage" under subsection 248(32) of the Act.

Of even wider scope is clause (iii), which includes advantages that are in "any other way related to the gift or monetary contribution."[42] It would appear that the addition of this requirement is intended to catch situations involving advantages that are neither provided in consideration of the gift (thereby giving the donor a enforceable right to the advantage), nor provided gratuitously in appreciation of the gift made. The inclusion of this clause suggests that is not necessary for a causal relationship to exist between the making of the gift and the receiving of the advantage if they are "in any other way" related to one another. Again, however, how far does the scope of this clause reach? It has the potential to be incredibly broad, and indeed some commentators have noted that it encompasses clauses (i) and (ii) and potentially renders them unnecessary.[43] Will there be any restrictions on its application? For example, a donor may enjoy an advantage that is in some way "related to the gift or monetary contribution" but that nonetheless is not directly conferred on the donor by any particular person.[44] Consider for example, the decision of *Rickerd v. M.N.R.*,[45] which although decided over twenty years ago, is nonetheless thought provoking. The taxpayer, in an attempt to gain exposure for his aviation writings, donated his articles and rights to these articles to the Department of National Defence, which was also his employer. He attempted to deduct his donations on the basis that they were gifts to the Crown. The Tax Review Board did not allow the deduction on the basis that he was motivated to donate the articles in order to gain publicity that would lead to the sale of further articles in the future. If the same factual circumstances from *Rickerd* are considered under subsection 248(31), it can be seen that it is likely an advantage would be found. Although no person would be directly conferring a benefit on the writer as a result of his donation, there would be a relationship

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[42] The third clause was inserted for the first time as part of the February 2004 package of proposed changes. This word is retained in the July 2005 amendments.

[43] Loukidelis, *supra* note 9 at p. 18. The section that follows is based on the work of Mr. Loukidelis, who has highlighted the case discussed in the next sentence and the interesting suggestions and issues it presents.

[44] *Ibid.*

[45] [1980] D.T.C. 1838 (T.R.B.).

between the gift and the benefit that the donor would ultimately receive arguably that advantage would have to be calculated and included for split-receipting purposes.

As this case demonstrates, prior to the introduction of the split-receipting amendments, the courts demonstrated their ability on a number of occasions to find linkages between donations and the benefits accruing to donors. Examples of such determinations can also be found in a trilogy of cases, *No. 688 v. M.N.R.*, *R. v. Zandstra*, and *R. v. McBurney*[46], all of which share similar factual scenarios. In each of these cases, parents of children attending private religious schools made donations to the schools in lieu of set tuition fees. Although the charities argued the parents were under no legal obligation to make the donations, the courts found that the parent donors received a benefit (their children's education) in exchange for the donations made and that a connection or relationship existed between the benefits granted and the gifts made. The impact of these cases and their potential impact and meaning for the split-receipting regime have been summarized as follows:

> What this summary of the cases reveals is that the courts took a pragmatic approach to the question of whether a donation was linked to a benefit that the donor received from the donee. In these religious schools cases, which occupy a key position in the jurisprudence in this area, the courts were bound neither by the manner in which the parties described the transactions that they entered into nor by their account of their subjective intentions. Instead, all of the surrounding circumstances were reviewed including the donor's pattern of giving to charities generally; the donor's record of giving to the school (did the person donate to the school only when he or she had children attending the school?); the identity of the donors and their relationship with persons attending the school; the school's sources of income; whether parents were required to donate to the school to ensure that their children could continue to attend it; and whether the school pressured parents to donate to the school.
>
> It is suggested that these cases will continue to provide guidance as to how the courts will approach the nexus question under subsection 248(31). Of course, the cases do not provide an exhaustive list of the factors that will be weighed by a court in determining the nexus issue, but they serve as a useful indication of the approach the courts have taken and will take under the new legislation. These cases, however, also serve as a useful background to a discussion of some of the problems inherent in the Draft Legislation.[47]

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[46] [1960] D.T.C. 130; [1974] D.T.C. 6416 (F.C.T.D.); and [1985[D.T.C. 5433 (F.C.A.).

[47] Loukidelis, *supra* note 9 at p. 20.

As an aside, it should be noted that there might be other possible consequences as a result of these provisions. Consider the following scenario. Instead of requiring people to pay to enjoy a downhill skiing event and, given the benefits associated with such an event, receive only a small split receipt, a charity decides instead to make the ski event "free" but require participating skiers to obtain a minimum number of pledges to partake in the activities. The charity would also encourage the participants to make personal pledges. It is possible that the CRA may find in this circumstance a taxable benefit should be applied to the skiers even though they are participating in the event for free. In light of the split-receipting rules, the CRA may continue to look for ways to address situations where there are benefits accruing to individuals, like in the example above, where the split-receipting rules may not be directly applicable. This example is just meant to make the point that the split-receipting rules may not be the only approach that the CRA takes in regard to these advantages issues.

Another interesting issue is whether naming rights will constitute an advantage for the purposes of the spilt-receipting regime - that is, whether the nexus between the naming right and the gift will be such to constitute a calculable advantage for the purposes of the Act. A naming right arises when a charitable donation is made in exchange for the right to name a program or piece of property belonging to the charity, such as the "Jane Doe Centre for Children's Health." A number of advance tax rulings issued by the CRA have provided that naming rights do not constitute an advantage for the purposes of the Act.[48] For example, in Advance Ruling 2005-0110701R3, the facts were as follows. Corporation A proposed to make a charitable donation. Corporation B, which held all of the shares of corporation A, also proposed to make a charitable donation. The charity agreed to name the funded programs after the individual who was the shareholder of Corporation B. In this circumstance, it was held that provided that there was no economic benefit associated with the naming rights, the amount of the advantage would be nil.

The CRA, in another very similar earlier ruling, stated their position regarding naming rights as follows:

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[48] See for example CRA document numbers 2005-0110701R3, dated March 16, 2005; 2005-0130381R3, dated July 13, 2005; and 2003-0043013, dated December 10, 2003.

> Provided that there is no prospective economic benefit associated with the naming rights described in the Agreement, it is our opinion that the amount of the advantage of such naming rights would be nil for the purpose of subsection 248(31) [now 248(32)] of the draft legislation released by the Minister of Finance.[49]

Although the conclusion reached by the CRA in regard to this issue appears fairly clear, the statement that there is no advantage so long as the naming right presents no "prospective economic benefit" for the donee raises some interesting questions. The conclusion reached by the CRA would appear to be clear in most circumstances - i.e. if a corporation wishes to make a donation in exchange for the promotion of its business name, an economic benefit will result, whereas, conversely, if a private individual wishes to make a donation in exchange for the use of a family name, no economic benefit will result. But what would be the answer in a situation where a donor's family name is also the name of the business, and his or her wish to acquire a sizeable charitable donation a personal family naming right indirectly produces a benefit for the business of the same name. Would the donor's intentions be of any import in this regard? Would it make a difference if the donor had no stake in the business in question, either directly or indirectly? A related scenario might be one where the business name is so inextricably linked to the family name of the person making the donation that the use of the family name for naming rights purposes may bring an indirect economic benefit to the business, even though there is no direct similarity between the family and business names. These issues and the questions they raise, although fairly specific, remain outstanding and no doubt will be addressed at some point in the future by the CRA or the courts when the split-receipting regime is fully operational.

(iv) <u>What is the timing of the valuation of the advantage?</u>

> *…value, at the time the gift or monetary contribution is made, of any property, service, compensation, use or other benefit … either immediately or in the future and either absolutely or contingently,…*

Although as noted above, for the purposes of subsection 248(32), the value of the advantage is to be calculated at the time that the gift is made, this does not preclude an advantage received prior to, at the same time as, or subsequent to the making of the gift by the donor , or an advantage that

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[49] *Ibid,* see 2003-0043013, dated December 10, 2003.

is contingent or receivable in the future from being included in the calculation of the amount of the advantage pursuant to the formula described above.

The result of these provisions is that there are no restrictions placed on the timeline that the gift and the advantage share - i.e. the gift does not have to occur before the advantage or vice versa so long as they are "in respect" of one another. Therefore, "[i]t makes no difference if a donor makes a gift of cash in consideration of the charity employing his spouse in the future, or if the charity hires the spouse in gratitude of the gift to be made in the future."[50] An advantage will have been conferred that is related to the gift. Again the question arises as to the scope of this term, which on its face appears almost limitless - i.e. will there be situations where the potential advantages to the donor fall so far in the future that it is not longer necessary to include it when calculating the amount of the advantage for charitable receipting purposes? Will there be situations where there are future advantages that are not considered at the time of the making of the gift but with the benefit of 20/20 hindsight may be readily apparent?

The issue of valuing the amount of a remote contingent advantage could be problematic, especially in light of the CRA's position that if the value of an advantage cannot be ascertained at the time of issuing the receipt, no receipt would be issued.[51] Would an appraisal be required? If the value of the advantage is not "fair market value" but is its "value," how would obtaining an appraisal, which is premised upon market conditions be of assistance? Would the service of an actuary be required in order to determine the present value of a remote contingent advantage be required? Who would pay for these expensive appraisals and actuarial reports? These are all questions that would need to be addressed in order to provide clarity to the charitable sector on how to comply with these proposed new split-receipting rules.

(v) <u>By whom is the advantage to be provided?</u>

Proposed subsection 248(32) is silent regarding who may provide an advantage to the donor for the purposes of the Act, thereby suggesting that it is not necessary that the advantage be derived solely from the recipient charity. This understanding is reflected in the technical notes to the subsection, which provide that "it is not necessary that the advantage be received from the

[50] Kepes, *supra* note 31 at p. 16.

[51] *Supra* note 20.

charity that received the gift." Presumably, this could include an advantage provided by a third party, even unbeknownst to the charity issuing the charitable donation receipt.

For example, Mr. X is a long-term supporter of ABC Charity. In order to induce his friend, Mr. Y, to help support ABC Charity's capital campaign, Mr. X promised to take Mr. Y out to dinner if Mr. Y makes a donation to ABC Charity. Since Mr. Y received the benefit of enjoying the free dinner as a result of his making the donation, the dinner was an advantage received by Mr. Y and the eligible amount of the gift would be the amount of donation made by Mr. Y less the value of the dinner. This would be the case even though ABC Charity may not have any knowledge about the arrangement between Mr. X and Mr. Y. Another example would involve a donor making a monetary contribution to a political party in return for obtaining a government contract.

(vi) To whom is the advantage to be provided?

> … the *taxpayer*, or a person or partnership who does not deal at arm's length with the taxpayer …

The proposed statutory language provides that the advantage may accrue to the taxpayer, or a person or partnership that does not deal at arm's length with the taxpayer. Again, this somewhat typical anti-avoidance language is broad, and adds an additional layer of persons to consider other than the donor. It also puts an additional onus on taxpayers and charities to ensure that advantages enjoyed by all relevant persons are properly accounted for, even those advantages of which the charity, and even the donor, may be unaware.

In the earlier example involving Mr. Y receiving a free dinner from Mr. X, if the facts are changed so that Mr. Y did not make the donation, but rather he asked his wife to make the donation instead does that change the result? Once the donation is made by Mrs. Y; Mr. X invites Mr. Y to dinner. Since Mr. Y and Mrs. Y are non arm's length persons, the eligible amount of the gift made by Mrs. Y would also need to deduct the value of the dinner enjoyed by Mr. Y, even though Mr. Y may not have told Mrs. Y of the free dinner, and even though ABC Charity may not know about the free dinner arrangement between Mr. X and Mr. Y.

Another difficulty with this provision is the use of the arm's length concept in the charity context. At arm's length is a tax concept describing a relationship in which the parties are acting

independently of each other.[52] The opposite, not at arm's length, covers people acting in concert without separate interest, including individuals who are related to each other by blood, marriage, adoption, common-law relationships, or close business ties. Both related persons and unrelated persons could be arm's length persons. While rules regarding whether related persons are arm's length are defied in the Act, whether unrelated persons are arm's length is a question of fact, determined by jurisprudence developed in the commercial context. Hence, how these rules apply to the charity context is unclear.

(vii) Additional examples of the outcome of the foregoing definition

The scope of the definition of the "amount of the advantage" in the Act is problematic. In brief, as outlined above, the definition provides that contingent and future benefits, accruing either to the donor or a person or partnership with which the donor does not deal at arms' length, received from any source may be advantages for the purposes of the Act.

For example, consider a situation where a charity receives a gift of land from a donor who has received some manner of benefit from a developer who owns property adjacent to the donated property in exchange for making the gift.[53] In this situation, unless the donor acknowledges the facts either voluntarily or when questioned, it would be almost impossible for the charity to ascertain the nature of this advantage by ordinary due diligence. However, this benefit, under the provisions of the Act, is supposed to be included when the charity calculates the "eligible amount of the gift" for receipting purposes, and unless the charity makes inquiries, this receipt may be revoked and the charity and donor may be subject to sanctions. This would be the case even if the charity satisfied itself that it did not provide an advantage, as clearly the scope of the subsection is broad enough to include advantages obtained from third parties.

Consider also the example of a donor who poses for pictures with his wife, a professional model, after agreeing to make a large donation to a charity. The agreement regarding the donation is publicized, various media outlets publish the pictures, and the wife of the donor receives increased modelling work as a result. According to the provisions of the Act, the advantage

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[52] Subsections 251(1) to (6) of the Act. See also Canada Revenue Agency, Interpretation Bulletin IT-419R2, "Meaning of Arm's Length" (8 June 2004).

[53] This example came from a presentation made by Margaret Mason at the November 2005 Canadian Association of Gift Planners seminar.

accruing to the donor's wife as a result of his donation should be included when the charity calculates his receipt.

These examples demonstrate the breadth of the proposed advantage definition, and the benefits seemingly disconnected from the donor that must now be considered when charities prepare charitable receipts.

(viii) What is the amount of the advantage in situations involving limited recourse debt?

Paragraph 248(32)(b) of the Act provides that the amount of advantage is also to include the amount of limited-recourse debt incurred in respect of a gift, as determined pursuant to newly proposed subsection 143.2(6.1), at the time when the gift is made. The purpose of this proposed amendment is to curtail abusive tax-shelter schemes involving limited-recourse debt.

Subsection 143.2(6.1) of the Act introduces a new definition of "limited-recourse debt." [54] The cumulative effect of paragraph 248(32)(b) and subsection 143.2(6.1) is to reduce the amount of the gift made by the donor by the amount of the loan borrowed if the indebtedness is of limited recourse to the lender or if there is a "guarantee, security or similar indemnity or covenant" in respect to that debt or other debts.[55]

Care should be taken, therefore, to ensure that any plan that involves the borrowing of funds to make charitable gifts is onside of the limited recourse provisions of the Act, as they can be somewhat stringent. For example, even if a debt may appear to be one of full recourse in that there is a right of enforcement against the borrower, it may be deemed, pursuant to subsection 143.2(7) of the Act, to be a limited recourse amount unless certain specified requirements are met. Bona fide arrangements in writing must be made to repay the debt in ten years or less and interest must be paid annually at least the CRA's prescribed rate within sixty days of each year-end of the borrower.

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[54] The December 2003 amendments proposed to curtail the use of arrangements involving limited-recourse debts by introducing a series of amendments to the Act, including the insertion of new subsection 143.2(6.1) to the Act, the amendment of the wording of subsection 143.2(13) before paragraph (a), the insertion of new paragraph (b) to subsection 248(32) introduced by the December 2002 Amendments, as well as the insertion of new subsection 248(34) to the Act. These changes had been included in the February 2004 amendments and the July 2005 amendments.

4. Obligations and Consequences

The issues arising from the proposed amendments described above may have negative consequences to both the donors and donees if they fail to conform to the requirements of the Act. Therefore, it is important to consider the obligations that both donors and donees have in regard to these requirements and the consequences that may result if such obligations are not met.

Charities have an obligation to ensure that they are properly determining the correct amount of a gift, including any advantage that may occur, for receipting purposes. The split-receipting regime attempted to codify this obligation through the introduction of proposed subsection 248(40) of the Act,[56] which requires a charity issuing a official donation receipt with an eligible amount over five thousand dollars to make reasonably enquiries of the donor concerning the existence of any circumstances that would cause the eligible amount to be less than the fair market value of the property.

There was great resistance to this proposed due diligence amendment because of the administrative burden that it would have placed on charities. It was not clear from the proposed changes what type of inquiry would be recognized to be "reasonable." In response to a submission made by the Government Relations Committee of the Canadian Association of Gift Planners, Len Farber of the Department of Finance in a letter dated November 22, 2005 advised that the Department "recognize the difficulties that have been brought to light by this proposal" placing an administrative burden on charities. Mr. Farber indicated that the Department is "prepared to recommend to the Minister of Finance that proposed subsection 248(40) be withdrawn."[57]

Notwithstanding the promised withdrawal of the proposed statutory onus on charities to make "reasonably inquiry," a charity must exercise due diligence in making inquiries to ensure that the

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[55] Subsection 248(34) is proposed to be added to the Act to deem repayments of limited-recourse debts as gifts in the year they are repaid. Lastly, subsection 143.1(13) is amended so that it is applicable to gifts and monetary contributions by including references to "gift or monetary contribution" in this subsection.

[56] This was proposed for the first time in the 2005 July amendments.

[57] Canada, Department of Finance, Letter to Canadian Association of Gift Planners (22 November, 2005).

charitable receipts it issues are accurate and reflect the fair market value of the property, the advantage, and the eligible amount of the gift received.[58]

Other than the onus on the charity to ensure that the amounts shown on donation receipts it issues are accurate, the donor of the gift also has an obligation to provide the information requested by the charity to the charity in order to receive a charitable receipt for the property transferred. The consequences of a failure of a donor or donee to make such inquiries or provide such information can be serious. Pursuant to proposed subsection 248(41) of the Act, if a donor fails to provide any required information, regardless of whether the charity has made inquiries, the eligible amount of the receipt will be deemed to be nil, i.e. no credit or deduction in respect of the gift will be made.

If a charity fails to make proper inquiries of the donor and thereby does not reflect the correct amount on its receipts, this could trigger the imposition of intermediate sanctions by the CRA, such as fines and other administrative penalties under section 188.1 of the Act in respect of taxation years that begin after March 22, 2004. It is not clear whether the penalties and sanctions under subsections 188.1(7) and 188.1(8) for issuing receipts with incomplete or incorrect information or under subsection 188.1(9) and 188.2(1) for issuing receipts with false information would apply. If it is the former, the charity could face a 5% penalty of the eligible amount on the incorrect receipt or 10% penalty upon repeat infractions within 5 years. If it is the latter, the charity could face a 125% penalty of the eligible amount on the false receipt, as well as suspension of its receipting privileges if the total amount of penalty for issuing false receipts exceeds $25,000 in the taxation year.[59]

In addition to the possibility of imposing the said penalties, gross mismanagement or continued inaction in this regard could result in the revocation of the charity's registered status under the Act.

If the charity is able to prove that it satisfied itself that it did not provide an advantage and that it made all reasonable inquiries as to whether any third parties provided an example (say for

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[58] See Theresa L.M. Man and Terrance S. Carter, *Charity Law Bulletin* No. 83, "Inquiries Still Required When Charities Issue Donation Receipts" (11 January 2006).

example it asked all the right questions but the donor did not disclose all the facts) it is hoped that it would be open for the charity to argue that it should not be subject to sanctions and penalties and that the exposure to such sanctions and penalties would rest solely with the donor. The clear question that arises is how charities and donors are ever going to be able to properly assess if there is an advantage; the nature and scope of the advantage; and the value of the advantage.

Depending on the factual situation involved, such charities may also run the risk of facing legal action by disgruntled donors. It remains unclear whether a charity that makes inquiries of donors but receives no information in return would face possible intermediate sanctions by the CRA for issuing incorrect or false receipts. It is likely that such a determination will be influenced by the facts at issue.

The extent of the due diligence that a charity should undertake in any situation must generally be judged on a case-by-case basis. Certain situations may involve more extensive due diligence if there is some reasonable factual circumstance that suggest it may be necessary (e.g. gifts of real estate, tangible personal property, private company shares, gifts of debt, gifts of partnership interests etc.). It may be that the best approach to be taken by charities is to develop and implement a gift receipting policy conforming to the highest standard in the circumstances, such as a questionnaire for donors to complete and possibly requiring donors to provide sworn statements under certain circumstances. It is important for charities to advise donors that donation receipts will be issued in compliance with the requirement under the Act and that only the eligible amount of the gift, not the full value of the donation given, will be stated in the donation receipt for tax deduction purposes by the donors.

Charities will also need to have a working knowledge of the proposed split-receipting and tax shelter rules in order that they may know when to "seek relevant information from donors where the need for such information is apparent to [the charities] in the particular circumstances"[60] and what information to seek in this regard. Having such an understanding is not limited to accounting staff and senior management of charities, but also staff that may be in contact with

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[59] For a more detailed review of this topic, please refer to Theresa L.M. Man, "Intermediate Penalty for Charities: Improper Donation Receipts", to be posted on website www.chairtylaw.ca in May 2006.

potential donors, such as fundraising and gift planning staff, as well as staff involved in promotion and marketing, since they will be preparing publication and promotional materials for charities that may induce donations from donors.

However, at a bare minimum, charities should be ascertaining information like that which follows (which is by no means an exhaustive list) from donors before ascertaining the amount of the advantage for charitable receipting purposes:

(i) Is the donor or a person or partnership with which the donor does not deal at arm's length receiving any advantage for making the gift from the charity or a related organization?
(ii) Is the donor or a person or partnership with which the donor does not deal at arms' length receiving any advantage for making the gift from a third party?
(iii) Does the donor or a person or partnership with which the donor does not deal at arms' length expect to receive any advantage for making the gift in the future?
(iv) Does the donor or a person or partnership with which the donor does not deal at arms' length have any contingent entitlement to any advantage for making the gift?
(v) If there is any advantage, what is its value?
(vi) Does the donor have any obligation in relation to any limited recourse debt in making the gift?
(vii) Was the donated property acquired through a donation tax shelter gifting arrangement?

In addition, it should be noted that this due diligence must always take place before the charity issues a receipt to the donor for the gift and not retrospectively; it must be made regardless of the type of donated property (i.e. cash or gifts in kind); and it must be made whether or not the donor is forthcoming with information regarding these issues. Charitable staff must be educated to these issues and thoroughly document all written and verbal correspondence with donors concerning these matters.

It is hoped that CRA will provide the charitable sector with administrative guidelines on the type of due diligence that would be required of charities when issuing split-receipts in this regard, such as what indicia that charities would need to be aware of in order to determine when to request information from donors, what type of information to request, how to document the requests made and information received from donors, and what steps to take when donors are not cooperative in providing information.

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[60] *Supra* note 57.

5. Other Related Issues

(a) Gifts between charities and disbursement quota

An interesting question that arises from the introduction of the new split-receipting regime is whether the new concept of gift, which is inextricably linked to the notion of advantage, applies equally to transfers between charities as it does to transfers by individuals and corporations to charities. In other words, will a transferor charity be considered to have made a gift to another charity (and an expenditure for disbursement quota purposes) even if it received an advantage, such as some manner of consideration, from the recipient charity as a result of the transfer.

It appears that there are strong arguments supporting the proposition that the new amendments governing the terms "gift" and "amount of advantage" in the Act are also meant to apply to inter-charity gifts. Firstly, CRA policy provides that its definition of gift (which references the receipt of an advantage) is to apply generally, "for purposes of the *Income Tax Act*," and not for some specific purpose. Moreover, there appears to be no authority for the proposition that the definition of gift should be interpreted differently in the context of inter-charity gift transfers. Finally, the idea that a more stringent definition of what constitutes a gift for taxation purposes should apply to transfers between charities than that which applies to transfers from individuals to charities does not appear in keeping with CRA policy regarding the charitable sector. This issue is still outstanding, but its resolution will have a great impact on the manner in which inter-charity transfers of property will be treated for disbursement quota purposes.

(b) Multiple donations by the same donor

Due to the complicated rules regarding what is meant by an "advantage," sometimes, it might be necessary for separate receipts be issued for multiple donations made by the same donor.[61] In situations involving multiple donations, the CRA indicated that it is a question of fact whether any advantage received relates to a single donation or to the series.

The CRA gave the example of a donor making 3 donations of $100 each to a charity, receiving no advantage for the first and third donations, but received a benefit of $90 for the second. As such, there should not be any receipt for the second donation because the advantage received was

over 80% of the donation made. Therefore, the charity could issue one receipt of $200 to the donor, but it might be less confusing to the donor if the charity were to issue 2 receipts of $100 each for the first and second donations, and explain to the donor that there was no receipt for the second donation.

However, in situations where the $90 advantage received by the donor was not specifically in relation to the second donation, but was in relation to all three donations, then the receipting would need to be different. For example, the charity, in appreciation of the donor making all three donations, the charity gave a book to the donor worth $90. In such circumstances, the receipt to be issued by the charity would be $210, being $300 less the $90 advantage.

(c) Different effective dates

It is also necessary to note that the various components of the new split-receipting rules involving "advantage" of gifts have effective dates:[62]

- subsection 248(30) (concerning intention to give) and 248(31) (concerning the eligible amount of a gift) apply to gifts made after December 20, 2002;
- subsection 248(32) (concerning amount of advantage) applies to gifts made after December 20, 2002, except that subparagraph 248(32)(a)(iii) (concerning an advantage that is in any other way related to the gift) applies to gifts made on or after 6 p.m. Eastern Standard Time on December 5, 2003, and that subsection 248(35)(b) (concerning limited-recourse debt) applies to gifts made on or after February 19, 2003;
- subsection 248(34) (concerning repayment of limited-recourse debt) applies to gifts made on or after February 19, 2003;
- subsection 248(38) (concerning anti-avoidance) applies to gifts made on or after July 18, 2005, and that the previous wording of subsection 248(38) proposed in the December 2003 Amendments applies to gifts made on or after 6 p.m. Eastern Standard Time on December 5, 2003, but before July 18, 2005;
- subsection 248(39) (concerning substantive gifts) applies to gifts made on or after February 27, 2004; and
- subsections 248(40) and (41) (concerning reasonable inquiry) apply to gifts made on after January 1, 2006.

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[61] Canada Revenue Agency, *Registered Charities Newsletter* No. 17 (winter 2004), and Canada Revenue Agency, document number 2003-0013427 (17 April 2003).

[62] See Theresa L.M. Man, *Charity Law Bulletin* No. 76, "July 18, 2005 Draft Amendments to the Income Tax Act Affecting Charities: Part I – Definition of Gift & Split-Receipting" (8 September 2005).

6. Conclusion

The proposed split-receipting regime, and in particular, the concept of "advantage" contained within it, raises many troubling questions and issues for charities attempting to comply with its rules. The definition of what constitutes the amount of an advantage for the purposes of the Act and the manner in which this amount is to be calculated for split-receipting purposes is less than clear. And the potential breadth of the terms used may lead to unexplained and potentially dangerous results for both charities and donors. Moreover, the regime imposes increased due diligence obligations on charities to ensure that they are correctly receipting in circumstances where it may be impossible for them to access the information they need in order to ensure that all advantages are properly included in the calculation of the eligible amount of the gift. One can only hope that the many grey areas that split-receipting regime presents will be clarified either through revising the proposed amendments before they are introduced to Parliament, enacting remedial amendments to the Act or by the CRA providing the charitable sector with administrative guidelines on these problematic compliance and interpretation issues.