Canadian Tax Foundation Fifty-Ninth Annual Tax Conference

November 25-27, 2007

PRIVATE FOUNDATIONS AND COMMUNITY FOUNDATIONS

Maria Elena Hoffstein

Fasken Martineau DuMoulin LLP

ehoffstein@fasken.com

tel: 416 865 4388

INTRODUCTION **1**

TYPES OF CHARITIES **2**

PRIVATE FOUNDATIONS **4**
1. Reasons for Establishing and Giving to a Private Foundation 4
2. Factors Limiting the Attractiveness of the Private Foundation 6

CHANGES TO THE ACT IN RECENT YEARS RELATING TO CHARITIES **7**
1. Increasing the Limit on Charitable Credits 7
2. Donation of Publicly Traded Securities and Zero Capital Gains 9
3. Non-Qualifying Securities 10
   (a) Excepted Gifts 12
   (b) Effect of Donating a Non-Qualifying Security 12
4. Loanbacks 14
5. Business Activity 15
6. Borrowing 16
7. Control of other corporations / Excess Business Holdings 17
8. Disbursement Quota 18
9. Non-Qualified Investments and Section 189 18
10. Excess Business Holdings Regime 20
   (a) Public Disclosure 20
   (b) Safe Harbour 20
   (c) Monitoring Phase 20
   (d) Divestiture Required 21
   (e) Relevant Persons 21
   (f) Trusts in which a private foundation has an interest 23
   (g) Compliance Period 23
   (h) Transitional Rule 24
   (i) Exempt Shares 24
   (j) Substituted Shares 24
   (k) Penalties 25
   (l) Anti Avoidance Measures 25

COMMUNITY FOUNDATIONS **26**
1. Advantages of Donations to a Community Foundation 26
2. Donor-Advised or Restricted Funds 29
3. "Gifts" and Retention of Control 33

CONCLUSION **37**

PRIVATE FOUNDATIONS AND COMMUNITY FOUNDATIONS*

M. Elena Hoffstein
Fasken Martineau DuMoulin LLP
ehoffstein@fasken.com

INTRODUCTION[1]

In recent years, we have seen the rise of two divergent trends in Canada's charitable and not-for-profit sector—"the third sector," as it has been dubbed. On the one hand, this sector has experienced tremendous growth. On the other hand, there have been significant and continuing cutbacks in government spending on the arts, education, and health care. Thus, a growing demand for funds to sustain charitable activities has encountered a shrinking public resource pool available to support philanthropic endeavours.

In an attempt to ease the pressure on the not-for-profit sector, the federal government has over the last several years introduced amendments to the Income Tax Act[2] (the "Act") that were designed to encourage private philanthropy through enhanced tax incentives. These amendments are a welcome addition to the Canadian legal landscape in that they provide enhanced tax incentives for charitable giving. In addition they have blurred the distinction between public foundation and charitable organizations.

However, along with these provisions, the government enacted new and stringent anti-avoidance and other rules. At the time they were first introduced, the loan back rules contained in subsection 118.1(16) of the Act were the subject of much criticism.[3] More recently, the newly

---

* Portions of this paper have been extracted from a paper by Maria Elena Hoffstein and Robin Roddey, Private Foundation and Community Foundations, (2001) Canadian Tax Journal Vol 49 No 5. pp 1258 and updated. In particular the tax sections of this paper have been updated to include relevant changes to the Act from 2001 up to and including the 2008 Federal Budget

[1] In CRA Registered Charities Newsletter No. 27, Fall 2006 it was noted that as of December 2005 the charitable sector comprised 82,243 charities. Of these, 4208 were private foundations, 4624 were public foundations and 73,391 were charitable organizations. In CRA Registered Charities Newsletter No. 28, Summer 2007 it was noted that in 2005/2006, the Charities Directorate received 3,734 applications for charity status and approved 2,926 and in 2006/2007 the Charities Directorate received 3601 for charity status of which 2,469 were approved. In CRA Registered Charities Newsletter No 29, Winter 2008 on the 40th anniversary of the introduction of registration of charities, it was noted that in 1967 when the Income Tax Act was amended to require charities issuing donation receipts to register and file annual returns with the Department, the Charities Section registered a total of 22,556 organizations. As can be seen, the number of registered charities has grown as has the organization that regulates them.

For an older study see Voluntary Sector Roundtable, Panel on Accountability and Governance in the Voluntary Sector, Building on Strength: Improving Governance and Accountability in Canada's Voluntary Sector (Ottawa: Voluntary Sector Roundtable, February 1999), 13. Where it was noted that there was a 33% increase in the number of registered charities from the 1980's and a 300% increase from the 1960's. The report does not provide any additional information on either the time period covered by these data or the source from which they were obtained.

[2] RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this article are to the Act.

[3] See Arthur B.C. Drache, "Federal Tax Changes and Personal Tax Planning," paper presented at Charity and Not-for-Profit Law: The Emerging Specialty, Canadian Bar Association—Ontario seminar, May 15, 1997, 11. See

enacted excess business holdings rules,[4] which were introduced at the same time as the measures extending the capital gains exemption rules for donations of publicly listed shares to private foundations, appear to be exceedingly complex and create additional restrictions in an area which is already heavily regulated.

These and other rules impose particularly onerous restrictions on the funding and activities of private foundations. The purpose of this article is to examine how the Act differs in its treatment of private foundations as compared with other charities and to consider this differential treatment in the context of donors' motivations in selecting a specific vehicle for their charitable giving. Having regard to those motivations, the article will examine the extent to which community foundations may present an attractive alternative to private foundations.

TYPES OF CHARITIES

The Act contemplates that charities will be designated as charitable organizations or charitable foundations. Charitable foundations, in turn, are categorized as public or private.[5] The designation is not affected by the form of the entity—it may be a trust, a corporation, or an unincorporated association, although it should be noted that while charitable organizations may be either corporations, associations or trusts, foundations must be constituted as either be corporations or trusts. The designation will affect the disbursement quota requirements of the charity, the rules relating to the gifts made to it, the activities and investments that are permitted, and the activities and investments that are prohibited.

Briefly, a charitable organization is an organization, whether or not incorporated, that meets all of the following requirements:[6]

- all of the organization's resources are devoted exclusively to charitable activities carried on by it;
- no part of the income is payable to or otherwise available for the personal benefit of any proprietor, member, shareholder, trustee or settler thereof; and
- it cannot be controlled by a group of related directors/officers/trustees.

---

also Blake Bromley, "Dolphins, Tuna and Mudsharks: Reflections on the 'Bre-X Budget' for Charities" (1997), vol. 14, no. 1 *The Philanthropist* 27-41.

4 The 2007 Federal Budget extended the elimination of the capital gains tax on gifts of publicly listed securities to private foundations. Prior to this Budget, this concession had been made only to gifts to charitable organizations and public foundations (see 2006 Federal Budget). At the same time, however, the 2007 Federal Budget introduced the excess business holdings rules, applicable to private foundations, to address concerns that persons connected with a private foundation might, through their combined shareholdings, be able to exercise undue influence for their own benefit. These rules place limits on the number of shares which a private foundation may hold having regard to the number of shares held by persons not dealing at arms length with the foundation and requires foundations to divest shares in excess of the allowed limits (see more comprehensive discussion later in the paper). The rules were contained in Bill C-28 which received Royal Assent on Dec 14, 2007 and enacted as Budget and Economic Statement Implementation Act, 2007 c. 35. See s. 149.1(1) definitions; 149.1(4); 149.1 (12) ; 149.1(15); 149.1; 188.1(3.1) and 188.1 (3.2).

5 Subsection 149.1(1), definitions of "charity," "public foundation," and "private foundation."

6 Ibid., definition of "charitable organization."

Typically, charitable organizations primarily engage in direct charitable activity. Examples include hospitals, universities, churches, art galleries and museums.

A charitable foundation is a corporation or trust that is constituted and operated exclusively for charitable purposes, subject to the restriction that no part of its income may be paid to or available for the personal benefit of any member, shareholder, trustee, etc., of the foundation, and that is not a charitable organization.[7] Charitable foundations generally act as conduits for distributing funds to charitable organizations. As noted above, a charitable foundation may be public or private. Like a charitable organizations, a public foundation cannot be controlled by a group of related directors, trustees, officers and like officials. A private foundation is a charitable foundation that does not meet the criteria of a public foundation.[8]

Essentially, a private foundation is one with either a non-arm's-length board or one that has received more than half of its capital from a single source. The classic family foundation, which has a majority of family members on its board and has been funded by one person or a related group, clearly meets this description. However, other charities also may fit within this category. It should be noted that, while a charity will be characterized as a charitable organization or a public or private foundation at the time of registration by the Canada Revenue Agency ("the CRA"), that status may be re-evaluated and the charity redesignated in the future. The Act currently provides that, with respect to charitable organizations and public foundations, more than 50% of the directors or trustees must deal with each other at arm's length and not more than 50% of the capital may be contributed by one person or a group who do not deal with each other at arm's length. Pursuant to proposed changes to the definition of charitable organizations and public foundations the current "contributions" test will be replaced by the "control" test. The reason for these proposed changes at the time was to permit charitable organizations and public foundations to receive large gifts without concern that they might be re-designated as private foundations.

The existing "contributions" test provided that if more than 50'% of the capital of a charity was contributed by one donor or a donor group, the charity would be deemed to be a private foundation and thus subject to the more stringent disbursement requirements and restrictions on activities and investments to which private foundations are subject.

---

7 Ibid., definition of "charitable foundation."

8 Ibid., definition of "private foundation."

Bill C-10[9] which received first reading October 30, 2007 reflects amendments, first tabled on December 20, 2002 which introduced the "control" test. When enacted, these amendments will be retroactive to January 1, 2000. The control test provides that a charity can be designated as a charitable organization or public foundation even if a person or group of persons not dealing at arms' length with each other has contributed more than 50% of the capital of the charity. However, such a person or group is not permitted to control the charity in any way nor may the person or the members of the group represent more than 50% of the directors/trustees/officers/ like officials of the charity. There is an exemption for funds from federal or provincial government, municipalities, other registered charities that are not private foundations or non profit organizations.

As a result of the proposed rules, when applying the "control" test, some registered charities may find that they are able to apply under ss. 146.1 (6.3) of the Act to change their designation. This must be done within 90 days after the Bill receives Royal Assent and if re-registered, will then be deemed to be registered as charitable organizations, public foundations or private foundations, as the case may be, in the taxation years that the Minister specifies.

As a result of the introduction of a "control" test, the rules in the Act relating to "control" will have to be considered including the term "controlled directly or indirectly in any manner whatsoever". The application of this control test in the charitable context is unclear, however, as these rules are premised on their application to commercial arrangements and in the business context. Charities that are involved in multiple structures or those which have a major donor or donor group who contributes more than 50% of the capital will need to exercise care that they not fall into the trap of being considered to be a private foundation.[10]

PRIVATE FOUNDATIONS

1. Reasons for Establishing and Giving to a Private Foundation

It must be recognized at the outset that in addition to the benefits that flow from any charitable gift—principally, the satisfaction of supporting worthy causes and the consequent tax relief—the private foundation offers a number of advantages for the donor that public foundations and charitable organizations may not be able to match. Some of these are related to the donor's philanthropic objectives and the manner in which they may be implemented over

---

[9] On October 29, 2007, the former Bill C-33 to amend the Income Tax Act was re-introduced in Parliament as Bill C-10. The former Bill C-33 was introduced in November 2006, containing a package of proposed amendments to the Income Tax Act that were first introduced by Finance on December 20, 2002. A number of the proposed changes will impact the operations of registered charities in Canada in a substantial way, including the definition of "gift," split-receipting, designation of charitable organizations and public foundations, revocation of charitable registrations, etc. These amendments have undergone various incarnations on December 5, 2003, February 27, 2004, and July 18, 2005, and were finally introduced as Bill C-33 in November 2006. C-33 passed third reading in the House of Commons on June 15, 2007 and first reading in the Senate on June 18, 2007. Since Parliament was prorogued in September 2007, Bill C-33 died on the Order Paper. Bill C-10 has now received three readings in the House of Commons on October 29, 2007 and received second reading in the Senate on December 4, 2007. The Bill has been referred to the Banking Trade and Commerce Committee of the Senate (with thanks to Theresa Man for this historical survey).

[10] See James M. Park, "New Developments and Challenges with CRA," Canadian Bar Association—Ontario, Continuing Legal Education, October 27, 2000.

time. Since, as contemplated by the definition in the Act, the board of directors of a private foundation does not deal at arm's length with the donor, the donor remains in a position to control—or, at a minimum, to influence—the future disposition of the gifted assets despite having parted with their ownership. This retention of control preserves flexibility in the event that the donor's charitable objectives change, or new public needs arise to which the donor would like to respond. The donor is also protected against the situation that may arise in the case of a gift to a public foundation or operating charity, where the charity's funding priorities change after the gift has been made, in a manner inconsistent with the donor's intentions.

Furthermore, the operation of a private foundation can become a charitable work in itself, allowing the donor (or donors, in the case of a family foundation) to feel more involved with the public benefits that flow from the gift than might be the case where a single, one-time gift is made to a large public foundation. Wealthy individuals may also regard the establishment of, and active involvement in, such a foundation as a valuable means by which to instil altruistic and philanthropic values in family members, particularly children and grandchildren.

There are, however, other features that make a private foundation attractive, which have less to do with philanthropic motives and the public benefit that will eventually result from the use of the funds or assets donated. In addition to the donor's ability to retain control over the distribution of income from the foundation's assets, the donor retains control over the investment of those assets. Many donors who, through their own business and investment acumen, have generated the wealth that allows them to make substantial charitable gifts may be concerned that the boards of public charities do not possess such acumen. Even where the assets donated are in the form of marketable securities, the private foundation structure allows the donor to "play the market" and select those investments that he or she believes will maximize return for the foundation. Continued control over the assets gifted may be even more important where the assets constitute shares or debt of the donor's corporation. Through the composition of the board of the foundation, control of the shares can remain in the family (subject of course to the excess business holdings rules and provincial statutes that may have application). Where the assets take such a form, a gift to a public foundation or an operating charity and the consequent loss of control may simply not be an option.[11]

Related to the issue of control is that of privacy. Since the board of the private foundation is generally composed of family members and trusted advisers, the donor can make the gift without necessarily disclosing details that he or she may prefer to keep confidential. Maintaining privacy may be particularly desirable in the case of private company shares or debt, where the disclosure of valuation and other details may provide insight into the underlying business. Such discretion may be impossible to maintain in the case of a gift to a public foundation, for a number of reasons. The public foundation may, for example, wish to disclose some of this information in its annual report. In addition, the public foundation may require a detailed review of the operations of the business in order to determine the value of the proposed gift of shares, not only at the time of the gift but also for each year in which the gift is not monetized or converted into cash. The risk to the donor is that crucial information about his or

[11] In addition, as will be discussed later in this article, the Act imposes certain restrictions on gifts of private company shares to public foundations.

her business may thus fall into the hands of competitors—some of whom may even hold positions on the board of the foundation.

Paradoxically, while a gift to a private foundation may preserve privacy concerning the gift itself, it can also bring the donor public recognition and identification with the foundation's charitable work. If the foundation bears the donor's name, it can provide a lasting reminder of the continuing contribution of the individual and his or her family to the community. Alternatively, the donor may establish the foundation in the name of some other individual whom he or she wishes to memorialize.

Lastly, the private foundation offers the donor advantages in matters of timing. The donor can make gifts at those points in time that best serve his or her fiscal and tax-planning objectives. The donor can make a charitable gift and realize all of the associated tax benefits without having to immediately select the charity or program that will ultimately benefit from the gift. This determination will subsequently be made, while perhaps not by the donor personally, by a board over which (as discussed above) the donor may be able to exert considerable influence.

2. Factors Limiting the Attractiveness of the Private Foundation

All of the foregoing makes it apparent that, when compared with other charities, the private foundation is something of a "half-way house." While a gift to a private foundation may represent a voluntary divestiture of the legal and equitable interests in the property conveyed (and thus satisfy the requirements of the Act for the issuance of an official receipt),[12] the donor or the donor's family may be able to retain many of the benefits of control. Furthermore, because of that control, the private foundation is often employed as much to achieve the donor's estate-planning and wealth management objectives as to give effect to the donor's philanthropic motives.

It is important, however, not to overstate the personal benefits to the donor of using a private foundation as a charitable vehicle. While the non-arm's-length relationship between the donor and the foundation's board may afford the donor some degree of control over investment and disposition decisions, the foundation is nevertheless a charity and subject to the same regulatory oversight as public charities. Thus, in Ontario for example, a private foundation is subject to the regulatory jurisdiction of the Public Guardian and Trustee (PGT), and that office can take such actions as are necessary to ensure that the non-arm's-length relationship between the donor and the charity does not give rise to conflicts of interest or other forms of abuse.[13] The foundation will also have to comply with the obligations imposed by the Charities Accounting Act,[14] certain provisions of which will be particularly relevant in cases where the property gifted to the foundation constitutes shares of a private company. Where a charity directly or indirectly controls a corporation, section 2(2) of the Charities Accounting Act provides that the corporation must furnish financial information to the PGT if it is requested to do so. Thus, in addition to the

---

12 Regulation 3500.

13 See *Re David Feldman Charitable Foundation* (1987), 58 OR (2d) 626 (Surr. Ct.), for an example of the exercise of this jurisdiction.

14 RSO 1990, c. C.10, as amended.

information that the foundation is required to provide to the PGT, the PGT is entitled to information provided directly by the controlled corporation.

Also significantly limiting the utility and attractiveness of the private foundation in Ontario is the Charitable Gifts Act.[15] In essence, that Act prohibits a charity from directly or indirectly holding more than 10 percent of an interest in a business carried on for profit. Where such an interest becomes vested in a charity, the charity is under an obligation to dispose of any interest in excess of the 10 percent threshold within seven years. The applicability of the Charitable Gifts Act is dependant on what is meant by the term "interest in a business". Does it refer to the situation where the charity holds more than 50% of the voting shares of the corporation or holds more than 10% of any single class of shares or holds more than 10% of the total issued capital? Or does it refer to a situation where the charity shareholdings entitle it to more than 10% of the profits? Or could it refer to a situation where a charity holds debt instruments reflecting an amount equal to more than 10% of the capital of the business corporation? Or does it refer to the situation where a charity through its holdings can appoint more than 10% of the directors? Or is it all of the above? There is no case law which might provide some guidance. Clearly, these provisions represent a significant obstacle to a donor who seeks to transfer control of a private operating company into a private foundation.[16]

Perhaps the most significant disincentives to the use of the private foundation are those found in the Income Tax Act and, in particular, the recent amendments referred to previously. It is necessary to examine these in some detail.

CHANGES TO THE ACT IN RECENT YEARS RELATING TO CHARITIES

1. Increasing the Limit on Charitable Credits

The income tax rules relating to charitable giving have undergone significant changes, particularly since 1996. For the most part, these changes have been welcome, in that they have enhanced the tax benefits of certain types of charitable giving—in particular, gifts of publicly traded securities. Until recently, enhanced tax benefits were not available for gifts made to a private foundation. However, the 2007 Federal Budget tabled March 19, 2007 eliminates capital gains tax incurred on the donation of publicly listed securities to private foundations on or after March 19, 2007. This also applies to donations of publicly listed securities by an arm's length employee who acquired the security under an option granted by the employer and which will exempt the associated employment benefit from taxation.

Subsection 118.1(1) provides in the definition of "total charitable gifts" that gifts made, inter alia, to a registered charity (which includes charitable organizations, private foundations, and public foundations) qualify as charitable gifts. Individuals are entitled to a federal tax credit for gifts that fall within this definition. The credit is 15.5 percent for the first $200 gifted and 29 percent for gifts over $200 (plus provincial tax and surtax savings). For a taxpayer at the top

[15] RSO 1990, c. C.8.

[16] See also discussion below regarding excess business holdings regime.

marginal rate, the credit is similar to a deduction once provincial tax considerations are factored in.[17]

There is a limit on the use of charitable credits for income tax purposes in any year. This limit was increased from the 20 percent level that had been in place from 1972 to the end of 1995 and the 50 percent level articulated in the 1996 budget. The rule now provides that an individual's total charitable gifts for a taxation year cannot exceed 75 percent of the individual's taxable income for that year. Any credits that are not utilized in a particular year can be carried forward for five years.[18]

Gifts that are made by will and properly structured are deemed to have been made in the year of death,[19] and the donation limit for gifts in the year of death has been increased from 20

---

[17] Under section 110.1, corporations are entitled to a deduction.

[18] Subsection 118.1(1).

[19] Issues have arisen with respect to gifts by will. These include the following:

(1) If there is a supervening life interest, can a charitable credit be claimed in the year of death? Yes, says the CRA, so long as there is no ability to encroach on capital before the gift vests in the charity. See *O'Brien v. MNR*, 91 DTC 1349 (TCC); and CRA document no. 9732295, March 20, 1998.

(2) Where the trustees have the discretion as to the timing of the charitable gifts, or the particular charity or charities to be benefited, or the amounts of the gifts, the CRA initially took the position that the charitable credit cannot be claimed in the year of death because it is not a gift by will. See CRA document no. 9732295, March 20, 1998; CRA document no. 9730365, February 25, 1998; *Interpretation Bulletin* IT-226R, November 29, 1991, paragraphs 3 and 6; and CRA document no. 9730875, February 17, 1998. A change from this position is found in CRA document no. 2000-0055825, March 8, 2001. In that document, the CRA states that where a will stipulates that a specific amount is to be gifted to charity and provides a list of charities to which donations should be made but discretion is left to the executor to determine the amount to be given to each named charity, the donation will qualify as a gift by will if the actions taken by the executor are reasonable and in accordance with the terms of the will and the donation is made to a charity that is a qualified donee.

(3) Where a testamentary gift is made to a foundation to be established after the death of the testator, the CRA initially indicated that there may be difficulties in claiming a charitable credit in the year of death since the charity is not then in existence. See "Table ronde sur la fiscalité fédérale," in *Congrès 99* (Montréal: Association planification fiscale et financière, 1999), question 11. Again, however, the CRA has since changed its position. Now the fact that the foundation did not exist at the time of the individual's death will not, in and of itself, preclude the donation from otherwise qualifying as a gift by will so long as the foundation is a qualified donee at the time the gift is actually made. See CRA document nos. 2000-0055825, supra, and 2000-0005187, March 6, 2001. The CRA also notes in the latter document that the completion of the gift should occur within a reasonable period after the date of death. If the gift to the foundation occurs after the assessment of the deceased's final tax return, the tax return may be reassessed, subject to the time limitations in the Act for reassessments, to allow a charitable tax credit for the gift to the extent that it is supported by an official tax receipt.

(4) For a more fulsome discussion, see Karen Cooper and Theresa Man, Planned Giving for High Net Worth Clients, 2006 Ontario Tax Conference, Oct. 16, 2006; Kathy Munro and M. E. Hoffstein, Making Donations Through a Will or Trust; Struggling with CRA Interpretations, Step Inside 4:1 (Fall 2004) M.E. Hoffstein, Alter Ego Trusts/ Joint Partner Trusts 2004 Canadian Tax Foundation.

percent to 100 percent in respect of gifts after 1995. Any portion of the donation that cannot be used in the year of death may be carried back one year. The donation limit of 100 percent also applies to the amount carried back.

The capital gains tax rules are relevant to the gifting of capital property since, in many cases, donors will realize a capital gain on such gifts. A gift is a disposition of property. The general rule, set out in paragraph 69(1)(b) and subsection 70(5), is that where gifts of capital property are made, inter vivos or by will, the taxpayer or the testator is deemed to have received proceeds of disposition equal to the fair market value of the property gifted. In addition, with respect to gifts of depreciable property, recapture of capital cost allowance may arise. Subsection 118.1(6) was intended to alleviate this potential tax burden and provides that an individual may elect as proceeds of disposition of the gifted property, an amount between the adjusted cost base of the property and its fair market value. The elected amount would then be the taxpayer's proceeds of disposition for determining the capital gain and also the amount to be used for determining the value of the charitable gift.

2. Donation of Publicly Traded Securities and Zero Capital Gains

Amendments to the Act have encouraged the donation of capital property to charities by permitting an additional credit in respect of a percentage of the capital gains. In addition to the 75 percent limit noted above, an additional claim can be made for 25 percent of the taxable capital gains realized on the disposition of the gifted capital property (to the extent that they were not excluded from taxable income by the lifetime capital gains exemption in section 110.6) and 25 percent of any recapture of capital cost allowance (in respect of a gift of depreciable property) included in income as a result of the making of the gift.

In the case of a donation of publicly traded shares to registered charities, an additional benefit involves a reduction to zero in the amount required to be included in income for tax purposes. This results from concession that began many years ago.

Paragraph 38(a.1) was introduced into the Act in 1998 (applicable after February 18, 1997). At that time, paragraph 38(a.1) provided that the rate of inclusion for capital gains realized on the donation of certain shares would be 37.5 percent where the following criteria were satisfied:

- The donation must have been made after February 18, 1997 and before 2002.
- The shares must have been listed on a prescribed stock exchange.
- The donor must have actually gifted the shares and not merely the proceeds from their sale.
- The donee must have been a registered charity other than a private foundation.

The rate of inclusion provided for in paragraph 38(a.1) represented one-half of the 75 percent rate of inclusion that was applicable in 1997. With the lowering of the rate of inclusion from three-quarters to two-thirds in the February 2000 budget, and its further lowering from two-thirds to one-half in the October 2000 economic statement, the rates of inclusion under paragraph 38(a.1) were lowered accordingly. The 2006 Federal Budget removed all capital gain tax on gifts of publicly traded securities to charitable organizations and public foundations but not to

private foundations. The 2007 Federal Budget tabled March 19, 2007, however, extended the zero rate capital gains inclusion rate to donations to private foundations given that from and after March 19, 2007 there is no difference in the treatment of gifts of publicly traded securities to any registered charity.

This benefit will also be available to gifts of publicly traded securities acquired by an arm's length employee under options granted by an employer and donated within 30 days after exercise. The 2008 Budget tabled February 28, 2008 extends the existing capital gains tax exemption for donations of publicly traded securities to capital gains realized on the exchange of certain unlisted securities (ex. shares or partnership interests) for publicly traded securities that are then donated to a charity. The capital gains tax exemption will apply to gains from an exchange if (i) the publicly traded securities are the only consideration received from the exchange, (ii) the unlisted securities included a condition at the time of issuance that allows them to be exchanged for publicly traded securities, (iii) if the publicly traded securities are donated after February 25, 2008 to a registered charity or other qualified donee within 30 days of the exchange. There are additional rules that apply to the exchange of partnership interests to ensure the economic appreciation of the partnership interests are exempt.

While the government's apparent bias against private foundations has softened in the area of allowing gifts of publicly traded shares to enjoy the zero rate income inclusion even if donated to a private foundation there are still areas where the rules are stricter for private foundations than the other registered charities.

3. Non-Qualifying Securities

There are, for example, provisions that will adversely affect charitable donations and the ability to issue charitable receipts in certain non-arm's-length situations. In essence, these anti-avoidance rules restrict the tax benefits available to donors who make gifts of certain types of assets to a private foundation.

Before these amendments, it was well known that the CRA had, for some time, been unhappy with arrangements that allowed donors to make charitable gifts that permitted them to receive tax credits while at the same time retaining the effective use of the donated property. A typical example would be the situation where the owner of a business donated funds to a private foundation of which he and members of his family were directors. The foundation would subsequently lend the funds back to the business with some interest charge, or it would acquire shares of the business and ensure that there were sufficient funds available to the charity (by way of dividend payments) to satisfy the disbursement quota requirements. Often the corporate debtor would take out a life insurance policy on the life of the donor so that on the donor's death, the insurance proceeds would be available to the corporation to repay the debt. Alternatively, the donor would gift a debt/note to the charity—that is, the shareholder who held a loan receivable from the company would gift it to the foundation.

This was the fact situation in the case of *Re David Feldman Charitable Foundation*.[20] The issue in this case was the propriety of a loan made by the foundation to a corporation. It

---

[20] Supra note 13.

came up, not in the context of an income tax review, but rather on a passing of accounts of the foundation invoked by the Office of the Public Trustee of Ontario (now the PGT) under the Charities Accounting Act.[21] One of the directors of the foundation was the principal shareholder of the debtor corporation. The loan was made at fair market rates, and the interest generated was used for charitable purposes. The court held that the directors of the foundation were in a conflict of interest in approving the loan and that the loan ought not to have been made, at least not without independent legal advice. The court also held that the foundation was a charitable trust and its directors were trustees, and that in authorizing the loan, the directors were in breach of trust. The court did not order the directors to pay damages since the charity had not suffered any loss. However, it refused to pass and approve the accounts.

Although the *Feldman* case was not a tax case, the CRA had expressed concerns about similar arrangements where private foundations lent money to corporations controlled by the donor. These concerns led to Resolution 21 of the 1997 federal budget wherein proposals were made to eliminate the opportunity for loanbacks.[22] In addition, that budget proposed to sharply curtail gifts of private company shares by introducing punitive measures. The draconian nature of these proposals was brought to the attention of the minister of finance, and a modified version was subsequently drafted and ultimately passed into law. While the revised legislation is a welcome relief from the original proposals, there are still problems and concerns.

The new provisions provided a mechanism for blocking gifts of private company shares and debt that fall into the category of "non-qualifying securities." A "non-qualifying security" is defined in subsection 118.1(18) as follows:

(a) an obligation (other than an obligation of a financial institution to repay an amount deposited with the institution or an obligation listed on a prescribed stock exchange) of the individual or the individual's estate or of any person or partnership with which the individual or the estate does not deal at arm's length immediately after that time;

(b) a share (other than a share listed on a prescribed stock exchange) of the capital stock of a corporation with which the individual or the estate does not deal at arm's length immediately after that time; or

(c) any other security (other than a security listed on a prescribed stock exchange) issued by the individual or the estate or by any person or partnership with which the individual or the estate does not deal at arm's length immediately after that time.

Gifts of private company shares by an individual who controls the company are caught by the definition, as are gifts of debt by an individual when the debt is in respect of a non-arm's-length corporation. Thus, for example, if a person lends money to a related company or person and donates that debt to a charity, the debt will be a non-qualifying security even if interest is charged on the debt. If the debt is a non-qualifying security, the rules will apply regardless of the intention of the donor. A third type of non-qualifying security is warrants or options, etc., gifted

---

[21] Supra note 14.

[22] Canada, Department of Finance, 1997 Budget, Budget Plan, Notice of Ways and Means Motion To Amend the Income Tax Act, February 18, 1997, resolution 21.

by an individual that do not qualify as shares or obligations issued by a corporation with which the individual does not deal at arm's length.

Shares, obligations, and other securities listed on prescribed stock exchanges[23] and amounts deposited with financial institutions are specifically excepted from the definition.

(a) Excepted Gifts

There are certain gifts of shares that do not fall within the definition of a non-qualifying security. These are called "excepted gifts." A gift that is an excepted gift will not be subject to the restrictive rules applicable to a non-qualifying security. Rather, tax relief will apply in the usual way.

An "excepted gift" is a gift of shares made to a charity that is not a private foundation with the proviso that the donor deals at arm's length with the donee charity and with each director, trustee, or officer of the donee charity.[24] It should be noted that this saving provision applies only to shares that are not listed on a prescribed stock exchange. It does not apply to debt.

The arm's-length requirement creates difficulties for potential donors of private company shares. Often, if a person is inclined to donate such shares, he or she will make the gift to a charitable organization or public foundation with which one or more members of the family are involved, usually at the board level. In this case, the gift will be considered a non-qualifying security. If such a gift were contemplated, perhaps the only way to avoid this characterization, and the consequent restriction of tax benefits, would be to have the related individuals resign from the board. Even so, it is not clear what the consequences might be if, after the gift was made, the related individuals returned to the board, or a related individual who was not previously a board member or officer was subsequently invited to join the organization.

Care must be taken to avoid turning an excepted gift into a non-qualifying security. This could occur if shares of a private family business corporation are gifted to a public foundation in circumstances where the corporation cannot distribute cash on the redemption of the gifted shares and chooses to satisfy the payment of proceeds of redemption by issuing a promissory note. That promissory note would be a non-qualifying security.

(b) Effect of Donating a Non-Qualifying Security

If a donation of a non-qualifying security is made, the donor will be denied a tax credit for the donation in the year in which it is made. That is, the gift is ignored for the purpose of the charitable donation tax credit.[25] However, if the non-arm's length connection between the donor and the issuer of the security is broken within the first 60 months or the recipient charity disposes of the security within 60 months of the time the donation was made, the gift will be deemed to have been made at the time the non-qualifying security is disposed of, or ceases to be non-

---

[23] Regulation 3201

[24] Subsection 118.1(19). See also comments by Arthur B.C. Drache in (January 1988), vol. 6, no. 1 *Canadian Not-for-Profit News* 1-2.

[25] Paragraph 118.1(13)(a).

qualifying.[26] The charity can then issue a donation receipt for the gift. The fair market value of the donation[27] will be deemed to be the lesser of

- the fair market value of the original gift as modified by any designation under subsection 118.1(6); and
- the value of the consideration received by the charity on the disposition of the non-qualifying security or, where the security ceases to be a non-qualifying security, the fair market value at that time.

A donor who makes a gift of a non-qualifying security and realizes a gain on the disposition may claim a reserve under the S.40(1.01) during the 5 year period until the gift is deemed to have been made.

For example, assume that Mr. X donates preference shares of a company controlled by him or by a person with whom he does not deal at arm's length. The shares are redeemable for $3 million. These shares will be a non-qualifying security, and hence no charitable donation will be recognized in the year in which the gift is made. However, if the company redeems the shares for their redemption amount within 60 months after the gift is made, Mr. X can claim a donation of $3 million in the year in which the shares are redeemed.[28]

---

[26] Paragraphs 118.1(13)(b) and (c). Subsection 118.1(14) provides that if a donee receives a new share in the course of certain corporate reorganizations in exchange for a share that was a nonqualifying security of the donor, the new share will be deemed to be the same share as the original share. Thus, if the new share is disposed of within 60 months after the donation of the original share, the individual will be deemed to have made a charitable gift under subsection 118.1(13).

[27] Paragraphs 118.1(13)(b) and (c).

[28] A number of questions arise with respect to the meaning of some key words in the definition of "non-qualifying security." These are "does not deal at arm's length" and "immediately after that time." *Interpretation Bulletin* IT-419R, August 24, 1995, discusses some of the criteria used to determine whether persons deal with each other at arm's length under the Act. See also section 251 of the Act. These sources indicate that an individual will not be at arm's length from a corporation where the corporation is controlled by the individual, a person related to the individual, a related group of which at least one person is related to the individual, or a trust in which the individual is beneficially interested. With respect to an estate, it would not be at arm's length with the corporation if the corporation was controlled by the estate, a person or persons beneficially interested in the estate (and thus not at arm's length with the estate), or a person or persons not at arm's length with a person beneficially interested in the estate. The following example highlights potential problems that can arise where a charitable gift is made by will. In this regard, it should be recalled that a gift in a will is deemed to have been made by the deceased person in the year of death.

Assume that Mr. X owns preference and common shares of a corporation. In his will, he bequeaths the preference shares to charity and the common shares to his children. Is the gift of the preference shares a non-qualifying security such that the gift will initially be denied? If Mr. X is the "individual who makes the gift," who is the "individual" who is not at arm's length with Mr. X "immediately after that time"? Is it Mr. X's estate or his personal representatives? The Tax Policy branch of the Department of Finance has confirmed orally that Mr. X is the "individual" for these purposes and that, following his death, the "individual" is the personal representative of Mr. X. However, at what stage in the administration of the estate can it be said that there is no longer a non-arm's-length relationship? What is the situation when the estate trustees distribute the shares to the children and wind up the administration of the estate? In what circumstances might the trustees be able to take the position that the estate has begun to deal at arm's length with the issuer of the preferred shares even though the children are the prime beneficiaries of the estate?

4. Loanbacks

Subsections 118.1(16) and (17) introduce another set of anti-avoidance rules. These relate to what are called "loanback" situations and address circumstances with which the government has long been unhappy. One of these situations is described in the *Feldman* case, discussed above. Another is illustrated by the 1999 tax case *Jabs Construction Limited v. The Queen*.[29]

In Jabs Construction, the facts, briefly,[30] were as follows. The corporate taxpayer had made a gift to a private foundation, which then loaned the funds back to the donor corporation. In the process, tax on a capital gain was eliminated. The transaction was challenged by the CRA on the basis that it offended the general anti-avoidance rule (section 245 of the Act). The court held, however, that it could not see how "the use of a specific provision of the Act that allows the tax consequences of a charitable gift to be mitigated can by any stretch of the imagination be a misuse of the provisions of the Act or an abuse within the meaning of subsection 245(4)."[31] The government's response to this decision was to enact subsections 118.1(16) and (17). These will apply to two types of situations.

The first situation is addressed by subparagraph 118.1(16)(c)(i). This provision applies where an individual has made a gift of property to a charity other than a non-qualifying security and, within five years of the time the gift is made, the charity acquires and holds a non-qualifying security of the individual. In such a case, subsection 118.1(16) applies to deny a tax credit in respect of the first donation.[32]

---

[29] 99 DTC 729 (TCC).

[30] For the interested reader, the following summary provides a more detailed account of the transactions involved:

- Pursuant to a settlement agreement between Jabs Construction Limited ("Jabs") and Callahan Construction Company Limited ("Callahan"), Jabs agreed to sell its 50 percent interest in 13 properties ("the properties") to Callahan. The properties were encumbered by mortgages totalling $4,833,709.
- Rather than sell the properties directly to Callahan, Jabs gifted them to the Felsen Foundation ("the foundation"). The controlling shareholder of Jabs was a director of the foundation. The remaining directors of the foundation were the controlling shareholder's wife and adult children.
- Immediately before gifting the properties to the foundation, Jabs borrowed approximately $3,293,000 from the foundation. This loan was secured by equitable mortgages on the properties.
- Pursuant to the doctrine of merger, these equitable mortgages were discharged upon the transfer of the properties to the foundation (thus relieving Jabs of the obligation to repay the loan).
- Pursuant to subsection 110.1(3) of the Act, Jabs elected proceeds of disposition equal to the adjusted cost base of the properties. (This entitled Jabs to a gift receipt in the amount of $8,335,751 and would avoid triggering any capital gains.) The foundation in turn sold the properties to Callahan for their fair market value of $17,745,000.
- The foundation used the proceeds from the sale of the properties to Callahan to pay off the mortgages and to loan additional money to Jabs.

[31] Supra note 29, at paragraph 46.

[32] The mechanism of denial is a reduction in the fair market value of the gift by the fair market value of the consideration given by the charity to acquire the non-qualifying security.

For example, assume that an individual makes a $1,000 cash gift to a charity, and two years later the charity lends $1,000 to a corporation that does not deal at arm's length with the individual. Alternatively, a charity lends $1,000 to a corporation and within five years thereafter an individual who does not deal at arm's length with the corporation makes a $1,000 gift to that charity. In both cases, the charitable receipt will be reduced by $1,000.

The second situation is addressed by subparagraph 118.1(16)(c)(ii). In this case, a gift of property other than a non-qualifying security is made to a charity by a donor who does not deal at arm's length with the charity and who subsequently uses the property within five years of making the gift. If the donor's use of the property was pursuant to an agreement made or modified no earlier than five years before the gift was made, and the use of the property was not in the course of the charity's charitable activities, again subsection 118.1(16) will apply to deny a tax credit to the donor.

An example of this type of loanback would be a situation in which Ms X makes a gift of a valuable painting to her private foundation and reaches an agreement with the directors of the foundation to keep the painting at her house. Another example would be a situation where Ms X makes a gift of real property to a charity and she or a person who does not deal at arm's length with her uses the property, even if she or he pays for such use. In both cases, Ms X will be deemed to have disposed of the property but will not be considered to have made a charitable donation.

There does not appear to be any subsequent recognition of the gift if the loaned funds or the "used" property is returned to the charity.

Subsection 118.1(17) is an ordering rule that operates to determine the order of the reduction in tax credits where subsection 118.1(16) applies. The technical notes to subsection 118.1(17) indicate that ordering is done on a "first in, first out" basis and give the following example: if, in each of years 1 to 3 a donor makes a gift of $100 and in year 4 the donee acquires a non-qualifying security of the donor for $130, subsections 118.1(16) and (17) will be triggered to eliminate the gift in year 1 and reduce the gift in year 2 to $70.

A donor must be careful not to inadvertently trigger the loan back rules.

5. Business Activity

The Act provides that a charitable organization or public foundation can carry on a related business but if a charity carries on a business that is not a related business of that charity, it can be subject to revocation of its registration as a charity[33]. A private foundation cannot carry on any business activities.

It is beyond the scope of this paper to discuss in any detail what constitutes a related business and reference should be had to Policy Statement CPS-019 effective March 31, 2003 where CRA sets out its policy for determining whether a charity is carrying on an acceptable business or an unacceptable business or (in the case of a private foundation) any business.

---

[33] Subsection 149.1(2) and (3)

It is noted in passing that CRA considers a "business" to involve a commercial activity -- deriving revenues from providing goods or services--undertaken with the intention to earn profit. In Policy Statement CPS-OI9 CRA discusses the difference between investments and carrying on a business and notes that a charity that holds interests in a partnership will be considered to be carrying on a business and not simply making an investment even though the charity plays no active role in the business. The rationale for taking this position is that under the laws governing partnerships, the partner carrying on the business (general partner) is generally treated as the agent of the partner providing the financing (the limited partner).

If a private foundation carries on any business or if a public foundation or charitable organization carries on a business that is not a related business, the charity in question could have its charitable designation revoked[34] or could be liable for a monetary penalty ranging from 5% to 100% of its gross revenues from the business for repeated infractions[35].

6. Borrowing

Private foundations cannot incur debt other than debts for current operating expenses, in connection with the purchase and sale of investments or in the course of administering charitable activities[36]. This rule also applies to public foundations[37] but not to charitable organizations.

For some time, the CRA interpreted this provision narrowly to permit only certain types of debt such as brokerage fees or other incidental amounts related to the purchase or sale of investments but not to debt incurred for the purpose of purchasing investments or the use of loan proceeds to discharge debts permitted under the act at the time the debt was incurred.

In a 2005 Technical Interpretation[38] CRA softened its position to the effect that it is permissible for foundations to incur debt for the purpose of acquiring investments. It is now also permitted for members and directors of foundation to lend money interest-free to enable the foundation to acquire investments, pay current operating expenses or expand on charitable activities. In that same Technical Interpretation, however the CRA notes that it will continue to monitor debt arrangements, in particular in non-arm's length situations to ensure there are no other issues in the arrangement, such as whether there is a "personal benefit"

---

[34] ss. 149.1(4) (a)

[35] ss. 188.1(1) and (2) and 188.2(1)

[36] ss. 149.9(4)(d)

[37] ss. 149.1(3)(d)

[38] 2005-015475117, October 2005 (and see Registered Charities Newsletter No 27; Drache, CRA reverses decades old policy on foundation borrowing 14(2) Canadian Not For Profit News 11-12 Feb 2006; Robert Hayhoe, Federal Court reviews CRA Undertaking Letter, ibid 13-14; Acorn Foundation 2005 CarswellNat 5606 (FC))

7. Control of other corporations / Excess Business Holdings

(a) Public Foundations

A public foundation is prohibited from acquiring control of any corporation and can have it charitable status revoked if it does acquire control of a corporation[39]. Penalties may also apply.

A charitable foundation (whether public or private) which acquires control of any corporation may be liable for a monetary penalty. The penalty can range from 5% to 100% of the total of all amounts of dividends received by the foundation from the particular corporation in the taxation year[40], the higher penalty being applicable if there has been a contravention of this rule in one or more of the prior five years.

The test for whether a public foundation controls a corporation varies with the penalty sought to be assessed.

Where the penalty is a monetary penalty, control is defined to mean the ownership by the foundation alone or together with persons with whom the foundation does not deal at arm's length of more than 50% of the issued share capital of the corporation having full voting rights under all circumstances[41]. For purposes of this test it does not matter if the foundation has purchased the shares or received them as a gift.

Where the penalty is the loss of charitable status, a charitable foundation will be deemed not to have acquired control provided it has not purchased or otherwise acquired for consideration more than 5% of any class (voting or otherwise) of shares of the corporation. Thus a gift of any percentage of shares will not result in a charitable foundation being considered to control a corporation. This relieves a charitable foundation from the extreme penalty of loss of charitable status but monetary penalties would still apply.

(b) Private Foundations

A private foundation may have its charitable registration revoked it if has in respect of a class of shares in the capital stock of a corporation a divestment obligation percentage at the end of any taxation year.[42]

With respect to monetary penalties, a private foundation is liable for a monetary penalty of 5% of the value of the excess holdings[43] increasing to 10% if a second infraction occurs within 5 years[44] or if the foundation fails to disclose certain information (see later discussion

---

39 ss. 149.1(3)(c) and see 149.1(12) for meaning of "control"

40 ss. 188.1 (3)

41 ss. 149.1 (12)

42 ss. 149.1(4)(c). This new rule applies to taxation years of private foundations that begin after March 18, 2007 subject to transitional rules found in ss. 149.2 (8). Section 149.1(4)(c) formerly provided that a private foundation could have its charitable registration revoked if since June 1, 1950 it acquired control of any corporation.

43 ss. 188.1(3.1)(a)

44 ss. 188.1(3.1)(b)(ii)

relating to excess business holdings for further clarification of these rules). It would appear that a private foundation may be liable to 2 monetary penalties, one pursuant to ss. 188.1(3) applicable to dividends paid and the other pursuant to ss. 188.1(3.1) applicable to the value of any excess holdings of a private foundation. A query has been made to CRA to determine if this is deliberate or if this requires technical amendment.

8. Disbursement Quota[45]

All registered charities are required to expend an amount each year in accordance with a disbursement quota. The disbursement quota is designed to ensure that an appropriate percentage of the funds donated to a charity are expended on charitable activities carried on by it and by way of gifts made by it to qualified donees (the 80% test) and to restrict the excessive accumulation of such funds or expenditure of such funds on administrative and fund raising expenses (the 3.5% test). The disbursement rules have evolved over the years such that the rules for charitable organizations and public foundations are now the same, subject to some transitional provisions and with some modest differences for private foundations.

Briefly there are two main elements to the disbursement quota rules:

Charitable organizations and public foundations must expend 80% of donations for which receipts were issued in the prior year, subject to some exceptions such as gifts of enduring property (which includes gifts given subject to a trust or direction to the effect that the property given or property substituted for the gift, is to be held for a period of not less than 10 years from the date that the gift was received, with some ability to expend the property before the end of that period to the extent that is required by the charity to do so to meet its disbursement quota obligations)[46]. With respect to gifts from other registered charities, charitable organizations and public foundations must similarly expend 80% of gifts from other registered charities received in the immediately preceding year, other than gifts of enduring property and specified gifts.

The disbursement quota rule for private foundations are very similar to those applicable to charitable organizations and public foundations except that private foundations must expend 100% of all amounts received from other registered charities in the immediately preceding taxation year (rather than 80%), other than specified gifts and gifts of enduring property.

All registered charities must also expend at least 3.5 % of the value of assets over $25,000 (determined on a rolling average basis) that are not used directly in charitable activities or administration. There is a transitional rule applicable to charitable organizations registered before March 23, 2004 to the effect that the 3.5% disbursement requirement will only begin to apply to their taxation years beginning after 2008.

9. Non-Qualified Investments and Section 189

In addition to these rules, the provisions of section 189 continue to apply. Under certain circumstances, these rules impose a penalty tax on issuers of nonqualified investments held by a

---

[45] Maria Elena Hoffstein and Theresa L. M. Man, New Disbursement Quota Rules under Bill C-33, Third National Symposium on Charity Law April 18, 2005.

[46] ss. 149.1(1)

private foundation. A non-qualified investment is defined in subsection 149.1(1) and can include a debt, a share, or a right to acquire a share.

In the case of a debt, the debt must be owing to the private foundation by

- a person who is a member, shareholder, trustee, settlor, officer, official, or director of the foundation; or
- a person who either alone, or as a member of a group of persons who do not deal with each other at arm's length, has contributed more than 50 percent of the capital to the foundation; or
- a person who does not deal at arm's length with any such person.

In the case of a corporation, a debt will be a non-qualified investment if the corporation is controlled by the foundation, by any person or group of persons described above, by the foundation and any other private foundation with which it does not deal at arm's length, or by any combination of these persons.

A non-qualified share investment will include a share in the capital stock of a corporation referred to above, held by the foundation, or held by persons not dealing at arm's length with the foundation. Shares listed on a prescribed stock exchange either within or outside Canada will not be included.

Rights to acquire shares that are non-qualified investments are also themselves a non-qualified investment.

If a non-qualified investment does not achieve a required minimum rate of return, a penalty tax will be imposed on the issuer of the investment for the period during which it is held, and the amount that will be payable is equal to the difference between the interest or dividends that should have been paid on the investment during the period and the amount of interest or dividends that was actually paid by the debtor or the corporation during the year or within 30 days of the year-end. Thus, as long as prescribed market rate interest or dividends are paid to the foundation, no penalty tax will be imposed.

In Registered Charities Newsletter No. 27 (Fall 2007) CRA gave the example of a mortgage that a private foundation acquires from a director. This would be considered a non-qualified investment of the foundation within the meaning of section 149.1(1) of the Act. The mortgagee must complete form T2140 every fiscal year. The tax payable can be reduced by the amount of interest paid during the tax year.

It is clear from all of the foregoing that the there are a number of provisions in the Act that may adversely affect gifts to private foundations. Donors wishing to gift private company shares (but not debt or other gifts that fall within the definition of "non-qualifying security") will be able to make such gifts only to public foundations or charitable organizations in order to benefit from the "excepted gift" provision.

10. Excess Business Holdings Regime[47]

As noted above, the Federal Budget tabled March 19, 2007 (passed as Bill C-28) extended the zero inclusion rate on capital gains available to gifts of publicly traded securities to charitable organizations and public foundations to gifts of publicly traded securities to private foundations.

Gifts of publicly traded securities to registered charities other than private foundations had been eligible for increasing reductions on the inclusion rate on capital gains since 1977 and as of May 2, 2006 were eligible for a total exemption. This preferential treatment was only extended to private foundations however in the 2007 Budget.

The concern expressed by the Department of Finance for the delay in extending the zero inclusion rate for private foundations was the possibility that "by virtue of their and the foundation's combined shareholdings, persons connected with the foundation have influence that they may use for their own benefit." To address such self dealing opportunities the 2007 Budget also introduced an "excess business holdings regime" that will apply to all private foundations and in respect of both publicly- listed and unlisted shares.

(a) Public Disclosure

The excess business holdings rules will require disclosure to CRA not only of the value of investment assets but also disclosure of the specific securities held. The new regime identifies three ranges of shareholdings by a foundation with different implications for the foundation for each range. Each share class of a corporation is considered separately.

(b) Safe Harbour

A safe harbour will exist where a foundation's holdings in a corporation for each class total 2% or less of all outstanding shares of that class.(defined in the Act as an "insignificant interest')[48]. In this circumstance there is no need for the foundation to divest or to monitor and report the holdings of any non-arm's length person to CRA[49].

(c) Monitoring Phase

Where at any time in its taxation year a foundation's holdings in one or more share classes exceeds 2% of the outstanding shares of that class, subsection 149.1 (15) will require the foundation to determine and report to CRA the name of the corporation and the shares that are held by the foundation at the end of the year in all share classes together with the shareholdings of all "relevant persons" in relation to the foundation and the percentage of the total shares held by each. The foundation must also report in its annual information return any "material transactions" (defined in ss. 149.1 (1) as an series of transactions (acquisitions or sales) by the foundation and its "relevant persons" which exceed the lesser of $100.000 worth of shares of a

---

[47] See footnote 4 for history of these rules

[48] 149.2(1)(b)

[49] 149.1 (1)

class and .5% of the total fair market value of all of the issued and outstanding shares of that class)[50].

(d) Divestiture Required

Where a foundation and all "relevant persons" together hold more than 20% of all outstanding shares in any share class of a corporation the divestiture requirement will be triggered. Subsection 149.1 (1) provides that a foundation will have an "excess corporate holdings percentage" if the percentage total of a class of shares held by the foundation and related persons exceeds the greater of 20% and the "entrusted shares percentage".

The entrusted share percentage is defined in subsection 149.1 (1) to mean the percentage of the foundation's shareholdings that meet the definition of entrusted shares. Entrusted shares are shares that are donated to a charity prior to March 19, 2007 which are subject to a trust or direction that the shares are required to be retained by the charity in perpetuity or for a period of time such that the charity cannot dispose of the shares. It is also provided that shares that are acquired after March 19, 2007 may also qualify as entrusted shares if the gift was made pursuant to a will or codicil that was executed prior to March 19, 2007 and not amended on or after that date and there is no other will executed or amended on or after that date or under the terms of an inter vivos or testamentary trust executed prior to March 19, 2007. Although entrusted shares need not be divested they are taken into account in determining whether other shares of the same class are subject to the excess business holdings regime.

Whether divestiture is required is determined by a complex formula set out in proposed subsection 149.1 (1). This formula requires a foundation to determine the excess corporate holdings percentage of a class of shares at the end of its fiscal period and to divest of any excess business holdings not divested in a prior year plus any net increase in excess business holdings acquired during the year. An allocation formula is found in subsection 149.2 (5). If the foundation’s excess corporate holdings percentage of a class of shares at the end of its current fiscal period is less than it was at the end of its previous fiscal period this constitutes a net decrease in the foundation's excess corporate holdings percentage and this net decrease can be used to meet its divestment obligations (but not future acquisitions) pursuant to an allocations formula found in subsection 149.5(7).

(e) Relevant Persons

A relevant person in respect of a private foundation means a person who does not deal at arm's length with the private foundation whether incorporated or not (determined as if subsection 251(2) were applied as if the private foundation were a corporation under that rule).

Excluded from that rule is a person who at that time is considered to deal not at arm’s length with the private foundation solely because of a right:

- to acquire shares of a corporation in which the foundation already owns shares("the Corporation") or to control the voting rights of that Corporation, or

---

[50] ss 149.1 (14)

- to cause the Corporation to redeem, acquire, or cancel any share owned by other shareholders or
- to control voting rights in respect of other shareholders of the Corporation, or
- to cause the reduction of voting rights in respect of shares owned by other shareholders of the Corporation[51]

The definition of relevant person also excludes individuals who are over 18 years of age and living separate and apart from an individual who controls or is a member of a related group that controls the foundation and who, upon review of an application by the foundation, the Minister deems to otherwise deal at arm's length with all controlling individuals.[52]

In order to understand the relevant person test it is necessary to understand the term "arm's length". The Act defines "arm's length". Basically this term describes a relationship where persons act independently of each other or are not related. Non arm's length, therefore, means persons acting together or in concert without separate interests or who are related.

Related persons include persons related to each other by blood, marriage or common law partnership or by adoption 251(2)(a). Related persons also include individuals or groups and the corporations in which they have a controlling interest and persons related to those individuals or groups are also considered related to those corporations 251(2) (b). Control for these purposes means the right to elect a majority of the board of directors of the foundation. Thus a relevant person includes individuals connected by blood, marriage or common law partnership or by adoption and also includes a private foundation and (i) a person who controls the foundation (ii) a person who is a member of a related group that controls the foundation and (iii) any person related to either of the persons referred to in (i) and (ii).

There is a further definition that applies to corporations. In this scenario, relevant person includes any two foundations or corporations:

- if they are controlled by the same person or group of persons,
- if the corporation is controlled by one person and the foundation is controlled by another person and they are related,
- if one of a corporation and the foundation is controlled by one person and that person is (i) related to any member of a related group that controls the other corporation or foundation or (ii) related to each member of an unrelated group that controls the other corporation or foundation,
- if any member of an related group that controls one of the foundation or corporation is related to each member of an unrelated group that controls the other,
- if each member of an unrelated group that controls one of the corporation or foundation is related to at least one member of an unrelated group that controls the other (ss. 251(2)(c)

---

[51] paragraph 251(5) (b)

[52] 149.1(1) "relevant person"

(f) Trusts in which a private foundation has an interest

For purposes of the transitional rules and the exemptions for entrusted and exempt shares the 2008 Federal Budget tabled February 26, 2008 introduces a "look through rule" to the effect that a foundation will be deemed to own shares held by a trust on March 18, 2007 in proportion to the value of the foundation's interest in the trust (relative to all interests in the trust) where the foundation is the sole trustee of the trust or if the foundation is a majority interest beneficiary of the trust and a majority of the trustees consist of the foundation and relevant persons. Assuming the shares of the trust would otherwise qualify as entrusted or exempt shares, that status will generally be retained and flow through to the foundation. Thus a trust may be a "relevant person" in respect of a private foundation. The rule would also apply in respect of divestment obligations for taxation years beginning on or after February 26, 2008[53].

(g) Compliance Period

The length of the period within which a foundation will be required to divest itself of excess shares will depend on the manner by which the excess arose.

If the foundation purchased shares which would result in an excess at the end of the year, the foundation will be required to divest itself of the excess before the end of that year.

If the excess arose as a result of the acquisition of shares by a non arm’s length person or by a donation to the foundation by a non arm's length person, the foundation is required to divest itself of the excess before the end of the subsequent taxation year.

If the excess is the result of a donation from an arm’s length party or a repurchase of shares by the corporation the foundation is required to divest itself of the excess before the end of the second subsequent taxation year.

If the excess arose as a result of a bequest, the foundation would be required to divest itself of the excess before the end of the fifth subsequent taxation year. The CRA will have the discretion to specify the conditions under which a private foundation might defer the year of divestment obligation (upon application by the foundation) by up to five additional years in certain limited circumstances such as for example if divestment of the shares within the normal compliance period would significantly depress the share price or where it is necessary to accommodate the requirements of securities regulators.

---

[53] “Majority interest beneficiary” is defined in ss. 251.1 (3) as follows. “*Majority-interest beneficiary*” – “majority-interest beneficiary”, of a trust at any time, means a person whose interest as a beneficiary, if any, at that time (a) in the income of the trust, together with the interests as a beneficiary in the income of the trust of all persons with whom the person is affiliated, a fair market value that is greater than 50% of the fair market value of all the interests as a beneficiary in the income of the trust; or (b) in the capital of the trust has together with the interests as a beneficiary in the capital of the trust of all persons with whom the person is affiliated, a fair market value that is greater than 50% of the fair market value of all the interests as a beneficiary in the capital of the trust.

(h) Transitional Rule

Shares held on March 18, 2007 will be subject to transitional rules to allow foundations to divest themselves of excess holdings over a period of five to twenty years[54]. Pursuant to these rules, the foundation's original corporate holdings must be reduced to more than 20% of the issued and outstanding shares by the end of that time. At least 20% of the excess holdings should be divested between the 5th and 10th fiscal period beginning on or after March 19, 2007. An additional 20% must be divested between the 10th and 15th fiscal period beginning on or after March 19, 2007 and any remaining excess holdings must be divested by the end of the 20th fiscal period beginning on or after March 19, 2007.

A foundation will be permitted to elect to be subject to the transitional rules when filing the annual return for the first year ending on or after March 19, 2007 and must report annually on the information return the percentage of shareholdings in excess of the 20% threshold

(i) Exempt Shares

The 2008 Federal Budget proposes to exclude from the divestiture requirements certain shares that are not listed on a designated stock exchange ("unlisted shares') that were held by a private foundation on March 18, 2007 (referred to as "exempt shares"). The reason given is that such shares often represent unique assets with no ready market and as such may be difficult to sell. As is the case with entrusted shares mentioned above, exempt shares will not have to be divested but will be taken into account in determining whether other shares of the same class are subject to the regime.

Specifically excluded from the concept of 'exempt share' is a share

- that provides the foundation with an indirect interest in listed shares of a class of another corporation (ex the foundation owns an unlisted share of a corporation that holds listed shares in another corporation),
- the indirect interest is held through a controlled corporation,
- if the foundation and relevant persons instead owned the listed shares they would hold more than 20% of the listed shares, and
- the foundation together with all controlled corporations holds more than 2% of the listed shares.

If a share ceases to be an exempt share, the change in status does not affect the divestment obligations in prior years. However the share will be treated as if it had not been exempt on March 18, 2007 and will therefore be subject to the existing transitional rules for the taxation years following the time the share ceased to be exempt.

(j) Substituted Shares

The 2008 Budget also proposes that substituted shares be treated the same as the shares for which they were exchanged for the purpose of the excess business holding regime, as for

[54] ss. 149.2(8)

example, shares acquired under the rollover provision of section 51(convertible property), 85 (share for share exchange), 86 (shareholder exchange on reorganization), or 87 (amalgamation). This will apply to the rules relating to entrusted shares or exempt shares and to the timing of divestment obligations and the transitional rules.

(k) Penalties

A penalty will apply in respect of a foundation's excess business holdings that have not been divested as required. The penalty is 5% of the value of the excess holdings[55], increasing to 10% if a second infraction occurs within 5 years[56] or if the foundation has failed to disclose in its T3010 Registered Charity Information Return (i) a material transaction of the foundation in respect of the class of shares; (ii) a material interest in the class of shares held at the end of the fiscal period by a relevant person; or (iii) the "total corporate holdings percentage" of the foundation in respect of the class of shares at the end of the fiscal period, unless the foundation at no time held more than 2% of this class of shares[57].

It is also possible that failure to comply with the divestiture rules will result in revocation of charitable status under ss. 149.1 (4) (c).

To encourage private foundations with excess holdings to divest in a timely fashion, donations that are made to a private foundation which has not completed its transition by the end of its first taxation year beginning after March 18, 2012 will be subject to tax on any capital gains resulting from the disposition[58].

(l) Anti Avoidance Measures

There are a number of anti avoidance measures, which are summarized below.

1. The Act provides[59] that if a foundation or a relevant person holds, directly or indirectly, an interest or right in a corporation other than shares, and the purpose was to avoid a penalty under the excess business holdings regime, those interests or rights will be deemed to have been converted into a number of shares of that class that would correspond in value to the value of the interest or right.

These deemed shares will be included in calculating the number of shares held by a foundation and the fair market value of such shares will be used in calculating any penalty that might apply.

---

[55] ss. 188.1 (3.1)(a)

[56] ss. 188.1(3.1)(b)(ii)

[57] Material transaction is defined in ss. 149.1 (1) as any series of transactions by the foundation or related persons, in respect of any class of shares of a corporation whose total value exceeds the lesser of 100,000 and .5 % of the total fair market value of all of the issued and outstanding shares of the class. Material interest is defined in ss. 149.2(1) as a % of shareholdings totalling greater than .5% of all the issued and outstanding shares of that class, or $100,000.

[58] Charity Law Bulletin No 113 March 29, 2007 Federal Budget 2007 Highlights for Charities by Karen Cooper and Terrance Carter, Carters Professional Corporation.

[59] ss. 188.1 (3.2)

2. If a foundation or relevant person engages in one or more transactions the purpose of which may reasonably be considered to avoid the definition of material transaction then each transaction or series is deemed to be a material transaction.

3. The 2008 Federal Budget proposes to extend the anti avoidance provisions to trusts and certain shares held by such trusts on March 18, 2007, in particular where it can be reasonably considered that one of the purposes of the trust is to hold or acquire shares or other rights in corporations that would, if they were held by the foundation or relevant persons would have to divest itself of shares to get out of the divestiture requirements. The provision would deem the foundation or relevant person to hold directly the shares held by the trust in the corporation which reflect the value of their indirect interest.

As a result of these new excess business holdings rules, it is anticipated that there may be some difficulty in building up the value of assets of private foundations which will in turn restrict the ability of private foundations to fund charitable activities. The advantage to private foundations of privacy may be lost due to the new reporting requirements. In addition the advantage which has recently been extended to private foundations of the zero capital gains inclusion on gifts of publicly traded securities may be offset by this new regime. As a result charities currently designated as private foundations but which may qualify as public foundations or charitable organizations under the new "control" test may wish to consider requesting redesignation.

In addition, given the onerous rules applicable to private foundations, taxpayers have looked to alternative entities as possible recipients of their charitable donations. Of particular interest are community foundations, a type of public foundation that offers several of the advantages of private foundations without compromising the desired tax benefits. These entities are the focus of the discussion that follows.

COMMUNITY FOUNDATIONS

1. Advantages of Donations to a Community Foundation

As discussed above, public foundations are those registered charities that do not apply all of their resources directly in carrying out charitable activities (and thus are distinguished from charitable organizations), and have arm's-length relationships with their donors and arm's-length relationships among a majority of board members or trustees (and thus are not categorized as private foundations). Public foundations exist in a variety of forms. For example, the so called parallel foundation is established to act as a fund-raising and fund administering entity for a particular operating charity, such as a hospital or art gallery. Other public foundations have a much broader focus, in many cases acting as a sort of umbrella organization for numerous operating charities on a national or an international scale. Between these extremes lie community foundations, which, as the name suggests, seek to support charitable works in a particular municipality or region. A community foundation has a somewhat broader focus than a parallel foundation, but nevertheless maintains a direct link to people and programs in the local community.

While Canada's first community foundation was established in Winnipeg in 1921, it is only in the past 20 years or so that these entities have established a strong presence in Canada. In 1990, when a national organization, Community Foundations of Canada (CFC), was formed, there were about 30 community foundations across the country. Today there are more than 150.[60] According to 2006 Annual Report, currently its members collectively administer more than $2.6 billion in assets, a 40% increase since CFC was established and collectively granted $137 million to local charities in 2006.

It appears that much of this growth may be attributed to the tax amendments reviewed above and what has been characterized as the CRA's "discriminatory" treatment of private foundations.[61] It may be that, given the disincentives to establish a private foundation, some donors who might otherwise consider this option are turning to community foundations with a view to obtaining similar benefits.

The advantages of giving to a community foundation have been summarized as follows:

> If a donor feels that he or she does not have sufficient funds to establish a private foundation, consideration might be given to gifting the amount to one of the well-run community foundations which will administer the funds for you. Fairly specific and detailed directions may be given to the community foundation on how you wish the income from the fund dispensed to charity. It is also possible to have the donor's name attached to that specific fund in perpetuity. . .
>
> Community foundations offer flexibility to the donor. At the time of creating the fund within the foundation, donors can name the fund, the purpose of the fund, and even the charity to be supported. Donors can designate that their gift be held in perpetuity with distribution to be made only from income; they can designate that distribution be made of principal as well as income, over a certain number of years; or they can work out any combination they want. No other philanthropic mechanism has the same flexibility.
>
> A donor wishing to create a fund has simply to instruct the community foundation in writing as to the name of the fund and what he or she wants done with the income from the fund, and subject to this being accepted by the Board of Directors of the foundation, and on receipt of the gift, these wishes will be carried out. . .
>
> The donor's fund is named in annual reports and other publications of the community foundation and thus receives recognition in perpetuity.[62]

---

[60] Similar growth in the community foundation sector has taken place in the United States. The period between 1992 and 1995 saw a 25 percent increase in the number of such charities, from approximately 400 to over 500: Victoria B. Bjorklund, "Charitable Giving to a Private Foundation: The Alternatives, the Supporting Organization, and the Donor-Advised Fund" (2000), 27 *The Exempt Organization Tax Review* 107-34, at 113-14.

[61] See, for example, an older paper by Wolfe D. Goodman, "Some Issues Relating to the Treatment of Private Foundations Under the Income Tax Act" (2000), vol. 16, no. 2 *The Philanthropist* 100-3.

[62] Wolfe D. Goodman and Howard Carr, *Establishing a Private Foundation* (Toronto: Canadian Centre for Philanthropy, 1987), 3 and 28-29.

This passage was written more than 20 years ago. As the introductory language suggests, at that time, gifts to community foundations represented an attractive alternative principally to those donors with insufficient funds to justify the establishment of a private foundation. With the recent tax amendments, however, even those donors who might otherwise have chosen to create a private foundation have shown increased interest in community foundations.

The features of a private foundation that may make it attractive to a donor have already been explained. As the above extract indicates, many of these advantages can also be enjoyed through a "donor-advised fund" under the control of a community foundation. For example, achieving public recognition of the donor's gift will usually be possible. In most cases, the community foundation will allow the donor to establish a permanent endowment fund bearing the name of the donor or of another person or persons designated by the donor. This name will continue to be associated with the fund as distributions are periodically made from income or capital.[63]

On the other hand, some of the other benefits that a private foundation may offer are absent in the case of a community foundation. For example, the personal satisfaction of operating a charity and the opportunity to instil charitable values in family members are for the most part lost when administration is relinquished to the community foundation. Similarly, the ability to protect the donor's privacy and confidentiality regarding the details of the gift are compromised. As well, the community foundation offers fewer advantages of timing and scheduling. While a gift to a private foundation can be made immediately and the eventual charitable use of the gift can be left to be determined at some future time, any directions and conditions imposed upon a gift to a community foundation must be determined and documented at the time the gift is made.

At the same time, the community foundation offers clear advantages to donors in the form of simplicity, administrative ease, and cost. The establishment and operation of a private foundation invariably involves legal and accounting costs that will, to a greater or lesser degree, reduce the funds available for charitable work. When a gift is made to a community foundation, the costs involved in establishing the donor's fund will largely be borne by the receiving foundation. With respect to ongoing administration costs, because these tend to be spread over all the funds managed by the foundation's fund administrator, generally costs for each fund are significantly lower than they would be in the case of a gift to a private foundation. Simply put, community foundations tend to benefit from certain economies of scale.

A donor-advised or donor-directed gift to a community foundation may best fulfill the donor's objectives where there is some doubt that the donor's zeal and vision will be sustained by subsequent generations. If the donor perceives that his or her family lacks the enthusiasm to take on the challenge of administering a private foundation, it may be preferable to establish a directed fund within a community foundation at the outset. Alternatively, if the original donor does not initially opt for a private foundation, members of the subsequent generation may find

---

[63] The CRA has confirmed in several technical interpretations that the stipulation that the donee use the donor's name in connection with assets transferred does not constitute a benefit or consideration that would deny characterization of the transfer as a gift. See, for example, infra note 80 and the discussion below under the heading " 'Gifts' and Retention of Control."

that turning the fund over to a community foundation is the best way to fulfill the charitable objectives of their ancestor.

This leaves for consideration the most significant issue of all: donor control. It must be asked whether in this most crucial of areas, the community foundation can approximate the benefits of a private foundation. It is also necessary to consider the extent to which community foundations may promise benefits in this regard that they may not be able to deliver. In order to appear as an attractive alternative to private foundations, community foundations offer to administer "donor-advised funds," agreeing to receive such gifts and promising to thereafter administer and distribute the assets in accordance with the donor's advice or direction. This is done under some form of "deed of gift," "memorandum of gift," "donor agreement," or similar document setting out the parties' rights and structuring their relationship on a prospective basis. To reserve to the donor the right to control the assets after their transfer to the foundation, such agreements may provide for obligations to consult with the donor (or members of the donor's family, or other designated advisers) regarding investment and/or disposition decisions. They may go further, obligating the foundation not merely to consult, but to obtain the donor's approval. Such agreements present two potential problems. First, ambiguously drafted restrictions may have an uncertain legal status, potentially exposing the foundation or its board members to liability. Second, excessively stringent restrictions on the foundation's freedom to deal with the assets may deprive the transfer of its character as a "gift" for income tax purposes.

2. Donor-Advised or Restricted Funds

As a result of the risk that a narrowly restricted gift will be found to be no gift at all, the tendency in donor agreements is to cast donor restrictions in weaker terms, providing, for example, that while the donor will be consulted, ultimate authority over investment and disposition decisions lies with the foundation. There is an obvious tension in drafting these agreements. On the one hand, there is the need to preserve the foundation's flexibility and to ensure a gift characterization, and therefore any restrictions must appear to have limited force. On the other hand, there is the need to satisfy the donor that the restrictions are binding upon the foundation. Of course, such agreements function satisfactorily so long as the donor and the foundation are able to reach a consensus on necessary administrative decisions. However, insufficient consideration appears to have been given by both donors and charities to the question of the parties' respective rights in the event of disagreement.

To some degree, this issue has been highlighted by the decision of the Ontario Court of Appeal in *Re Christian Brothers of Ireland in Canada*.[64] The case concerned the exigibility of a corporate charity's assets to satisfy tort claims arising out of the charity's work. In reaching a decision, the court was required to examine the ways in which such a charity holds its assets. Blair J of the General Division affirmed that a charity's property is presumptively not trust property:

> A charitable corporation does not hold its assets "as trustee" for charitable purposes . . . . It holds its assets beneficially, like any other corporation. As a matter of corporate law, of course, it must use those assets in a manner consistent

[64] (1998), 37 OR (3d) 367 (Gen. Div.), var'd. (2000), 47 OR (3d) 674 (CA).

> with its corporate objects, and its directors have fiduciary obligations to ensure that such is the case. Where its corporate objects and its charitable purposes coincide—as they do in this case—it must use its assets in a manner consistent with those charitable purposes. Nevertheless, this does not mean that it holds all of its assets in some kind of trust capacity.
>
> The law in this jurisdiction does not support the proposition that all assets received by a charitable corporation such as The Christian Brothers of Ireland in Canada by way of a gift or bequest are presumptively received in trust, and held by the corporation "as trustee" for the charitable purposes of the corporation, as opposed to being held beneficially by the corporation and required by its objects to be used for such purposes.[65]

Blair J did, however, go on to find that notwithstanding the fact that a charity's assets were generally held absolutely and beneficially, it was possible for a charitable corporation to receive property subject to express trust obligations. As with any other trust, this required the "three certainties": certainty with respect to the settlor's intention to create a trust; certainty as to the subject matter or property being settled on trust; and certainty of the beneficiaries or objects.[66] Where these requirements were satisfied, the assets received would be regarded as being held upon "specific charitable purpose trusts," to distinguish them from assets that, being held beneficially, could be applied to any of the charity's general charitable purposes.

Blair J also considered an intermediate category of charitable assets: those that were given without true trust obligations but had been "earmarked" by donors for some particular charitable purpose. The court found that such earmarking or informal expression of a donor's wishes or intentions did no more than create a "precatory trust":

> A "precatory trust" is not a trust at all. Where the donor gives or bequeaths the property to the charitable corporation absolutely and merely imposes some sort of moral obligation on the corporation to use the property in a certain way—using words of expectation or desire or purpose, but not words indicating that the donee is not to take the property beneficially but only for the objects or purposes described—no charitable purpose trust is established. The charitable corporation takes the gift or bequest and holds it—and any property derived from it—for the general charitable purposes and objects of the corporation. . . .
>
> Property emanating from contributions made through general fundraising campaigns, or even through fundraising campaigns for particular projects, . . . might fall into this category.[67]

---

[65] Ibid., at 390-91 (Gen. Div.). See also *Asian Outreach Canada v. Hutchinson* (2000), 28 ETR (2d) 275 (Ont. Sup. Ct.); and *Public Guardian and Trustee v. Aids Society for Children (Ontario)*, [2001] OJ no. 2170 (Sup. Ct.).

[66] Waters, Gillen, Smith, *Law of Trusts in Canada*, 3d ed. (Scarborough, ON: Carswell, 2005, 107.

[67] Supra note 64, at 396-97 (Gen. Div.).

As regards the exigibility of a charitable corporation's assets to satisfy tort claims, Blair J applied well-established principles of trust law. Assets held beneficially for the corporation's general charitable purposes were available to tort claimants because "compensation for such wrongs is caught within the rubric of the furtherance of those charitable purposes."[68] Exigibility was narrower in respect of assets held on "special charitable purpose trusts." Where the charitable corporation held assets in its capacity as a trustee, those assets were not available to its creditors (including tort claimants) generally, but would be available only to satisfy claims arising out of charitable activities related to that particular purpose.

On appeal, Feldman JA rejected even this narrowly circumscribed form of charitable immunity, holding that all of a corporate charity's assets were available to satisfy tort claims. However, the reasoning by which the judge reached this conclusion creates a number of uncertainties in this area of the law.

For the most part, Feldman JA appears to have accepted Blair J's classification of charitable assets. In summarizing the decision at first instance, she wrote:

> [Blair J] stated as a general principle that a charitable corporation does not hold its assets as trustee for its charitable purposes but rather holds them beneficially as does any other corporation. . . .
>
> A precatory trust is not a true trust, but rather an expression of the desire of the donor to have the funds used for a specific purpose without the creation of a true trust for the purpose. That desire is not binding on the corporation and such funds are beneficially owned by the corporation and not shielded from execution. Blair J. included in this category funds raised through general fundraising campaigns or even campaigns for a particular project of the corporation.
>
> This is to be distinguished from the case where the three certainties of a trust are present: certainty of intention, certainty of subject-matter and certainty of objects (in this case charitable purposes) so that a charitable purpose trust is created.[69]

There is no suggestion in her reasons that Feldman JA took issue with any of these propositions. Indeed, the judge expressly agreed that, while a corporate charity presumptively holds its assets beneficially, it could act as a trustee:

> The authors of *Tudor on Charities*, 8th ed. (1995), p. 159, have extrapolated . . . the proposition that a charitable company may hold particular property on trust for specific charitable purposes, distinct from its other property, and that "clearly to misapply such property would be a breach of trust." I agree with the authors of *Tudor on Charities* as to the obligations of the charity when it accepts such a gift, but with the following qualifications: (a) as long as the charity is in operation, and

---

[68] Ibid., at 396.

[69] Supra note 64, at paragraphs 20 and 24-25 (CA).

(b) subject to any *cy-près* order of the court, the charity would be obliged to use the funds for the purpose stipulated by the trust.[70]

Feldman JA does not adequately explain why such trust obligations disappear upon the charity's ceasing to operate; clearly, the insolvency or winding up of a non-charitable trustee does not have this effect. Furthermore, the subsequent portion of Feldman JA's decision suggests that the satisfaction of tort claims allows for recourse to all assets held on trust even where the charity's operations are not being wound up. This is the troubling inconsistency in the judgment: on the one hand, it recognizes that a charitable corporation may hold particular assets subject to trust obligations; on the other hand, those trust obligations appear not to produce the legal consequences normally following from legal, but not beneficial, ownership.

Fortunately, it does not appear necessary to resolve these difficulties in Feldman JA's judgment for the purposes of the present discussion. Both Blair J and Feldman JA appear to have been of the view that a charitable corporation may receive donations either beneficially or upon a special charitable purpose trust, and that a sharp distinction is to be drawn between these categories. In other words, there was agreement with respect to the limited legal significance of donor-expressed intentions and wishes where these fall short of imposing clear trust obligations.[71]

This holding is of critical importance in circumstances where a community foundation is required to make an investment or disposition decision and the foundation and the donor are unable to reach a consensus on the preferable course of action. The determination of whether the donor's recommendation must be implemented or whether the foundation's board is ultimately free to do what it regards as being in the best interests of the foundation turns on whether the donor's gift was subject to true trust obligations; that is, whether the donor agreement establishes a "special charitable purpose trust." Donor agreements that blur this distinction create significant liability risks for the foundation.

Take, for example, a scenario in which Mr. X makes a donation to a community foundation under the terms of an agreement indicating that the foundation will give effect to Mr. X's distribution recommendations. If, in the future, the foundation were to disregard such wishes and recommendations with respect to a particular distribution, a court might find it to be in breach of trust on the basis that the donor agreement evidenced a trust requiring distribution decisions to be made on the basis of a consensus between Mr. X and the foundation. On the other hand, if the terms of the agreement are construed as merely precatory, not imposing binding obligations, and the foundation gives undue weight to Mr. X's recommendations or directions, the foundation's board of directors may be held liable for any loss sustained on the grounds that

---

[70] Ibid., at paragraph 76.

[71] In the *Aids Society for Children* decision, supra note 67, the court suggested that even where no trust obligations were imposed, a corporate charity owes its donors a fiduciary duty. However, the substance of that duty is simply to apply donated funds to the charity's stated charitable objects. There was no suggestion in the decision that this fiduciary duty obligated the charity to implement specific donor-expressed wishes.

deferring to Mr. X's wishes represents an improper delegation or abdication of the directors' duties as trustees and fiduciaries.[72]

Similar problems can arise with restrictions giving (or purporting to give) the donor the right to direct the manner in which the transferred assets will be invested. Consider, for example, a situation in which a community foundation accepts a gift subject to a donor stipulation that the moneys granted remain invested in a particular stock, and that stock subsequently begins to decline in value. If the stipulation is merely precatory, the first obligation of the foundation's board is to dispose of the stock so as to preserve the corporation's capital and protect its charitable purposes. The failure to do so would likely be regarded as a breach of the directors' fiduciary duties to act in the best interests of the corporation, as well as a breach of the trust obligations owed by virtue of their deemed trustee status under the Charities Accounting Act. On the other hand, if the donor has settled the funds on an express trust, pursuant to which the foundation, as trustee, has investment powers limited to investing in the specified stock, the first obligation is to retain that stock.[73] While that investment, viewed objectively, may be imprudent, a trustee in the foundation's position would be powerless to dispose of it; to do so would be a clear breach of trust.[74]

3. "Gifts" and Retention of Control

In light of the foregoing, it must be concluded that donor control can be assured only where the foundation assumes true trust obligations. It then becomes necessary to consider whether such restrictions deprive the donation of its voluntary and gratuitous nature, such that it is no longer a "gift" for which a charitable receipt may be issued.

---

[72] Waters, supra note 66. at 858. While the strict rule against delegation has been modified somewhat, allowing trustees to retain professional advisers, the duty to act personally and not defer to the decisions of others, or to place the trustees' decision making in the hands of others, remains.

[73] Ibid., at 1287: "It is the first duty of the trustees to preserve the trust property and to carry out the trust terms. Unless the settlor chooses to give them such power, they have no authority to vary the terms of the trust, any more than they can neglect their duty to preserve the trust property. Nor does it matter whether the term which the trustees would like to vary is concerned with the beneficial interests created by the trust or the powers of themselves as trustees. It follows that, even if the trustees honestly and reasonably believe that it would be for the benefit of the beneficiaries were the trustees to depart in any way from any term of the trust, nevertheless they would be in breach of trust were they to do so."

[74] Arguably, if the terms of the trust require the trustees to hold some wasting asset or some investment that is expected to depreciate significantly, the trustees may be under an obligation to apply to the court to vary the terms of the trust to remove the restriction on the investment power. In an extreme case, blind adherence to the trust terms may itself constitute a breach of the trustees' obligation to preserve the trust corpus. There are cases in which courts have held that trustees are not permitted to remain inactive merely because of the limitations imposed by the trust instrument. For example, there are a number of cases in which the administration of a trust has been paralyzed by a deadlock between co-trustees: unable to agree on a particular course of action—for example, whether to make certain investments—they take no action. Courts have expressed the view that a trustee may not be able to justify its own inaction on the grounds that it was unable to secure the co-trustee's agreement. If there is sufficient risk to the trust or its proper administration, there is an affirmative duty to bring the matter to court and, in effect, have the court cast the deciding vote: see *Fales v. Canada Permanent Trust Co*., [1977] 2 SCR 302, var'g. (1974), 55 DLR (3d) 239 (BCCA), var'g. (1974), 44 DLR (3d) 242 (BCSC). In England, there is now a statutory obligation on charitable trustees to apply for a cy-près or administrative scheme if trust terms create problems in trust administration: see H. Picarda, *The Law and Practice Relating to Charities*, 2d ed. (London: Butterworths, 1995), 464-65.

The term "gift" is not defined in the Act. It may reasonably be asked whether a charity can be said to receive a gift if it acquires only the legal interest in property as a trustee and not the beneficial interest. The CRA's information circulars and interpretation bulletins also fail to provide a complete answer to this question. *Interpretation Bulletin* IT-110R3 does make clear that certain donor restrictions will make the gift ineligible for an official receipt:

> A charity may not issue an official receipt for income tax purposes if the donor has directed the charity to give the funds to a specified person or family. In reality, such a gift is made to the person or family and not to the charity. However, donations subject to a general direction from the donor that the gift be used in a particular program operated by the charity are acceptable, provided that no benefit accrues to the donor, the directed gift does not benefit any person not dealing at arm's length with the donor, and decisions regarding utilization of the donation within a program rest with the charity.[75]

What is the effect, however, where the donor has given more than a "general direction" as to the use of funds, and decisions with respect thereto do not entirely "rest with the charity" because of the trust constraints imposed by the donor? Arguably, these conditions would exceed the degree of limitation regarded as permissible under IT-110R3, and thus the donation would not qualify as a gift for which a receipt may be issued.

The better view, however, is that a donation made subject to trust restrictions consistent with a charity's objects—thereby establishing a "special charitable purpose trust," in the language of the *Christian Brothers* decision—is as much a gift for the purposes of the Act as an unrestricted gift. The extract from IT-110R3 quoted above clearly indicates a concern that donor restrictions not enure to the benefit of the donor or others with whom the donor does not deal at arm's length. In other words, the concern is with a sham gift that is merely channelled through a charity.[76] Understandably, such a gift is not regarded as a gift to the charitable organization, or given in support of its charitable purposes, and thus it does not justify a deduction from taxable income. On the other hand, the quoted extract clearly authorizes donor directions that restrict the application of funds to a particular program within the charity's broader charitable objects. There appears to be no reason why the mere fact that this direction or restriction is in law a trust obligation should render the donation ineligible as a "gift."

Moreover, this view is supported by the previous case law in which the meaning of the term "gift" in the Act has been considered. The concern is consistently whether the donor has

---

75 *Interpretation Bulletin* IT-110R3, June 20, 1997, paragraph 15(f).

76 This appears to have been the concern in *Curlett v. Minister of National Revenue*, [1966] Ex. CR 955, rev'd. on other grounds (1967), 60 DLR (2d) 752 (SCC). In this case, the taxpayer had made a gift to the Salvation Army and "pointed out" two individuals whom the taxpayer felt were in need of charitable assistance. A representative of the Salvation Army investigated the taxpayer's recommendation and agreed that helping those individuals was within the charity's general welfare work. Upon finding that the Salvation Army was "under no compulsion and no direction from the appellant" to assist those individuals, the court held that the taxpayer had made a bona fide charitable gift entitling him to a deduction. Presumably, an enforceable direction to assist named individuals would have required the court to treat the taxpayer's "charitable" gift as a personal gift to those individuals merely channelled through a charity.

parted with property without the receipt, or the promise of future receipt, of compensation.[77] While a disposition by way of trust rather than gift may have consequences for the donee, from the perspective of the donor the disposition is absolute and gratuitous. Thus, it is appropriate to regard property transferred to a charity under a trust as a disposition that entitles the donor to deduct the value of that property from his or her taxable income.[78]

In one specific context, the Act is explicit in stating that a donation to a charity may be a "charitable gift" notwithstanding that it is subject to trust obligations. The "disbursement quota" defined and quantified in subsection 149.1(1) is calculated on the basis of 80 percent of the amounts for which a charity has issued official receipts other than, inter alia,

> a gift received subject to a trust or direction to the effect that the property given, or property substituted therefor, is to be held by the foundation for a period of not less than 10 years.

Thus, the Act expressly contemplates that an official receipt may be given for a gift subject to trust obligations. It appears that, so long as those trust obligations do not benefit the donor or persons with whom the donor does not deal at arm's length, a trust donation to a charity is as much a "charitable gift" as is an absolute donation.[79]

Several CRA advance rulings have also recognized that where a donor imposes conditions on the transfer of assets, this does not, in itself, deprive the transfer of its character as a gift. For example, the CRA has stated:

---

[77] See *R v. McBurney* (1985), 20 ETR 283 (FCA); and *Littler v. Minister of National Revenue* (1978), 20 NR 541 (FCA). The position in the case law is also consistent with the definition of "gift" in Registered Charities and the Income Tax Act RC 4108*, p6.* The tax advantage received from gifts to charities (that is, the charitable receipt) is not normally considered a benefit that negates the gift: see *Friedberg v. Minister of Nat'l Revenue* (1991), 135 NR 61 (FCA), aff'd. on other grounds (1993), 160 NR 312 (SCC).

[78] See also *Guaranty Trust Co. v. Minister of National Revenue* (1966), 60 DLR (2d) 481 (SCC), in which the Supreme Court of Canada held that a gift, although subject to trust obligations, was an "absolute and indefeasible" gift that could therefore be deducted under the Estate Tax Act.

[79] Under the US taxation regime, gifts subject to obligations reserving to the donor the power to make decisions respecting investments and distributions also qualify as charitable gifts; however, where this degree of control exists (as opposed to circumstances where the donor may give non-binding recommendations), the fund is afforded the less favourable tax treatment applied to a private foundation: see Treas. reg. section 1.507-2(a)(8), as discussed in Bjorklund, supra note 31, and M.A. Bank, "Community Foundations: Are Donor-Directed Funds New Vehicles for Utilizing Community Foundations?" (1993), 7 *The Exempt Organization Tax Review* 42. Some of the factors that the Internal Revenue Service will consider include the following:

- The community foundation's solicitations (written or oral) state or imply that the donor's advice will be followed, or the donor's pattern of conduct creates such an expectation.
- The advice of a donor is limited to distributions of amounts from his or her fund, and the community foundation has not either made an independent investigation to evaluate whether the donor's advice is consistent with charitable needs most deserving of support by the foundation, or promulgated guidelines enumerating specific charitable needs that it will serve (or, if such guidelines exist, they are inconsistent with the donor's advice).
- The community foundation solicits only the donor's advice as to distributions from the donor's fund, and no procedure is provided for considering advice from other persons.
- The community foundation follows the advice of all donors concerning their funds substantially all of the time.

> Where the donor and a charity enter into an agreement that the charity will use the donated property in a manner which is consistent with the ordinary objects and operations of the charity, and which does not result in any benefit accruing to the donor or a person not at arm's length with the donor, our view would be that the gift would not be tainted by the general direction.[80]

Similarly, the CRA has ruled that the recognition and use of a donor's name will not taint the gift. In one instance, the reason for providing the favourable ruling was stated as follows:

> In previous files, we concluded that the fact that there are conditions attached to a gift does not, in itself, negate the gift (jurisprudence does not provide that conditions negate a gift). As with the other files, the donor in this case is freely parting with the funds or property, receives no benefit, other than recognition, in return and the funds or property can never revert to the donor or any related person.[81]

Thus, it is not restrictions imposed upon the donee, but rather only benefits to the donor, that will deprive a disposition of its characterization as a gift. Furthermore, incidental benefits such as favourable tax treatment or recognition of the donor's philanthropy are not regarded as benefits that deprive the gift of its voluntary and uncompensated character. Nevertheless, excessive donor control after disposition and significant limitations on the donee's freedom to deal with the property may lead to the conclusion that no gift has been made. An illustration of a degree of donor control that exceeds the permissible limits is offered by the US Tax Court decision in *The Fund for Anonymous Gifts v. IRS*.[82] The plaintiff Fund for Anonymous Gifts ("the fund") sought a declaration that it was a charitable organization entitled to tax-exempt status. The fund enabled benefactors to make donations, thereby entitling them to an immediate tax deduction, while continuing to control the investment of the funds donated and ultimately to direct distributions to operating charities. The trustee of the fund was compelled to implement the donors' directions because the gifts were made subject to enforceable conditions subsequent. The trustee was bound to comply with the conditions so long as such compliance did not require the trustee to violate Internal Revenue Service (IRS) regulations, as would, for example, a direction to make a distribution to a non-charitable recipient. In the material part of its analysis, the court stated:

> The manner in which the Fund's investment activity would be conducted makes clear that one of the purposes of the Fund is to allow persons to take a charitable deduction for a donation to the Fund while retaining investment control over the donation. This is so because the Trustee is bound by the conditions attached to the donations as to the "terms or conditions for retaining such transfers," to the "use

---

[80] CRA document no. 1999-0007035, February 8, 2000. See also CRA document no. 9731345, February 25, 1998; and CRA document no. 9613015, September 24, 1996.

[81] CRA document no. 9902413, September 1, 1999.

[82] 97-2 USTC paragraph 50,710 (DC CA 1997). After the decision was released, the fund amended the trust agreement under which it was established, striking out the provision allowing for donor-imposed conditions subsequent. On the basis of this change, argued on appeal, the judgment at first instance was vacated and the case remanded for reconsideration: 194 F.3d 173 (DC CA 1999).

> or disposition of the transferred property," and to the "acts required of the Trustee in the management of such property, or the disposition of income from assets attributable to such transfers," unless any of these conditions require that the Trustee make a donation to a non-exempt organization or to an individual for a noncharitable use. Therefore, other than this exception, the Trustee is fully bound by the investment instructions attached to the donation. The investment activity therefore allows the donor to control the investment, to make a risk-free investment, and to take a charitable deduction for his donation.
>
> Such risk-free investment activity is clearly not an exempt purpose. Although the income made by the investment will be donated to a charitable purpose, this activity benefits the donor because the donor controls the investment. The purpose, therefore, of this potentially money-making activity is not to make charitable contributions but to allow the donor to control the investment. If the true purpose of the Fund is to make anonymous charitable donations with the income resulting from these investments, it is unclear to the Court why the Fund is specifically organized to allow the donor to have full control over investment decisions. In addition, under this scheme, the donor receives the Trustee's investment services for free. It is the ultimate recipient who pays for the Trustee's investment services because under the Agreement, the fee is deducted from the donation.[83]

Therefore, although the donor did not retain legal or beneficial ownership of the funds donated, and did not receive the income generated by the investment of those funds while under administration by the fund, the court held that such donations were not charitable gifts.[84] Of course, to some degree this result is a function of aspects of the US taxation regime that differ somewhat from Canada's tax laws. Indeed, the court's holding was not that the donors had not made *gifts*, but that these were not charitable gifts because the fund was not a charity. Nevertheless, the decision is an indication of how courts may be inclined to treat charitable gifts to public foundations that, through the mechanisms of a trust or conditional gift, attempt to reserve to the donor many of the benefits that would otherwise be available only through the use of a private foundation.[85]

CONCLUSION

It appears that a donor can approximate the type of control offered by a private foundation by making a gift to a community foundation, subject to donor restrictions that constitute true trust obligations. Absent trust obligations, the donor restrictions are somewhat

---

[83] Ibid., at 89,854-55 (DC CA).

[84] It does appear, however, that because the restrictions were imposed as conditions subsequent, the trustee's refusal to implement donor directions might cause the property to be returned to the donor (that is, the non-fulfillment of the condition subsequent would cause the gift to fail). Yet the court placed little stress on the possibility that the property might be returned to the donor, emphasizing instead the benefits to the donor while the property remained with the fund.

[85] In *The Fund for Anonymous Gifts*, supra note 82, at 89,853 (DC CA), the IRS argued that "the structure and expected operation of the Fund reveals that it was organized to circumvent the restrictions on private foundations and limitations on charitable deductions."

illusory: those restrictions will (and, indeed, can) be given effect only so long as the donor's advice and recommendations are in accordance with the decisions that the board of directors regards as being in the foundation's best interests. However, while a trust may satisfy the donor's objectives in this regard, such a gift may be much less attractive from the foundation's perspective.[86] Clearly, the assumption of trust obligations in respect of discrete donor-advised funds adds to the foundation's administrative burdens. Furthermore, board members are understandably reluctant to assume the obligations of trustees when these may come into conflict with their fiduciary obligations in respect of the assets the foundation holds absolutely. Finally, there are unsettled issues regarding the interplay between the administration of trust assets and beneficially held assets. For example, if a donor directs that his or her segregated fund be invested in speculative stock, should the foundation seek to achieve a balanced portfolio by investing its own (that is, non-trust) assets in bonds and similar low-risk securities?[87]] Beyond these additional burdens that "special purpose charitable trusts" would impose upon the community foundation, there remains the outstanding question of when excessively stringent trust terms—particularly where these "benefit" the donor by reserving some measure of control—will disqualify the donation from recognition as a charitable gift.

For all of these reasons, the practice of community foundations has been to solicit and establish donor-advised funds on terms that do not create trust obligations. This is achieved by drafting donor agreements that include provisions clarifying that the assets transferred will be held in the foundation's "normal corporate capacity"; provisions expressly stating that the agreement is not intended to create trust obligations; and provisions making it clear that while the donor may make recommendations, final decision-making authority rests with the foundation. This is clearly the preferable practice; for the reasons discussed above, it is not prudent to use ambiguous donor agreements whereby the foundation assumes control while purporting to grant that control to the donor.

While an unambiguously drafted donor agreement will clarify a foundation's legal obligations, such an agreement will also highlight the donor's relinquishment of control. For donors for whom the retention of control is important, it will be equally apparent that a donor-advised fund administered by a community foundation is not, in all respects, a substitute for a private foundation. It is clear from the growing use of donor-advised funds that, for many donors, this is not a problem. While some donors seek a continuing role in the charitable distributions made from the assets gifted to the community foundation—and, to a lesser degree, in the investment of those assets pending distribution—others are satisfied with an advisory or

---

[86] The problems that a corporate charity might face where it accepts a gift subject to trust obligations were adverted to in the *Christian Brothers* decision, supra note 64, at paragraph 79 (CA), where Feldman JA noted, "We do not know to what extent large charitable corporations accept donations to be held in perpetuity on trust for a particular purpose within their charitable objects, and thereby accept true trust obligations with respect to such donations. Some of the issues that would confront the corporation if it were prepared to accept a donation on such terms include: what would be involved in keeping separate accounts, how and to what extent other corporate funds could be used and applied to the operation of the trust property, the effect of the application of other funds from the charity to the purpose for its ongoing operation or for other purposes."

[87] In principle, it seems that to approach the matter in this way would be to disregard the discrete nature of a trust and its corpus. The well-established prohibition against the commingling of funds held in trust, either with other trust funds or with funds that the trustee holds absolutely, suggests that the foundation should effect an appropriate diversification of its investments without regard to other property being held in trust.

consultative role. Many individuals will gladly relinquish absolute control so as to be relieved of the administrative costs and burdens. For such donors, a donor-advised fund in a community foundation is an attractive alternative to the establishment of a private foundation. There will, however, remain a class of donors for whom the advantages of a private foundation cannot be approximated by a donor-advised fund.

It is clear that there are numerous motivations and considerations behind each donor's decision to make a substantial charitable gift. The way in which these various factors are weighted and prioritized is likely to determine the donor's choice of the preferable vehicle for charitable giving. For donors whose primary concern is the ability to remain directly involved in the administration and disbursement of assets after making a gift, the private foundation may still be the most attractive option. On the other hand, the Act imposes significant restrictions and limitations on gifts to private foundations, and these constraints will discourage many donors from employing such a vehicle.

For donors who are prepared to relinquish ultimate control over assets donated to charity, the community foundation may be an attractive alternative. Through the establishment of a donor-advised or donor-directed fund, the donor can continue to play an active role in the administration and application of the assets donated without facing many of the restrictions imposed on private foundations. Among the principal tax benefits of giving to a community foundation (that is, a public foundation under the Act) are the increased inclusion rate for capital gains on publicly traded shares, and the community foundation's ability to issue charitable receipts for gifts of private company shares as "excepted gifts." As discussed above, the donor also realizes non-tax benefits in the area of administrative ease and convenience. Where establishing a private foundation may impose significant demands on the donor's time and attention, a community foundation will administer the funds, keep the requisite records, issue receipts, and deal with other potentially time-consuming matters of administration.

While there is a compromise in the area of control, the donor-advised or donor-directed fund within a community foundation is likely to appeal to many donors. It is a means by which the donor (or persons designated by the donor) may remain involved in investment and/or disbursement decisions, without assuming the administrative burdens of establishing a private foundation and without attracting certain disadvantageous tax treatment. Even where the community foundation's donor agreement makes it clear that ultimate decision-making authority rests with the foundation, many donors are likely to be satisfied with such a consultative or advisory role. Within these limits, the donor-advised fund with a community foundation may be an attractive alternative to a private foundation.