

NEW CCRA GUIDELINES ON SPLIT-RECEIPTING

By Theresa L.M. Man, B.Sc., M.Mus., LL.B. and Terrance S. Carter, B.A. LL.B

A. INTRODUCTION

On December 24, 2002, Canada Customs and Revenue Agency ("CCRA") released Income Tax Technical News No. 26 that contained proposed new guidelines on split-receipting to explain CCRA's new administrative policy in relation to "*determining whether there is a gift in situations other than where there is an outright transfer of property for no consideration.*" Technical News No. 26 also dealt with a number of common gifting situations. Existing interpretation bulletins and publications of CCRA will be revised in order to reflect the new administrative guidelines. Although interested parties were permitted to provide comments on the proposed guidelines until March 31, 2003, CCRA indicated that the proposed guidelines may be followed in the interim. This Charity Law Bulletin provides a summary of the new guidelines adopted by CCRA as set out in Technical News No. 26.

B. PARALLEL LEGISLATIVE AMENDMENTS

Technical News No. 26 indicated that the new guidelines were developed in consultation with representatives of the Department of Justice and the Department of Finance. As a result, the proposed new guidelines were released in conjunction with the Department of Finance releasing proposed amendments to the *Income Tax Act* (the "Act") on December 20, 2002 in order to "*facilitate the interpretative approach being adopted by CCRA.*" One of the new amendments introduced was a new definition of "gift" for income tax purposes. In this regard, subsections 248(30), (31), (32) and (33) of the Act are to be amended to reflect this new concept.

Details of this new definition of "gift" for income tax purposes were set out in our Charity Law Bulletin No.

21, dated April 30, 2003, entitled “Commentary on Draft Technical Amendments to the Income Tax Act Released on December 20, 2002 that Affect Charities.” Readers are encouraged to refer to the said Charity Law Bulletin at www.charitylaw.ca as background for this Bulletin.

C. SUMMARY OF THE NEW SPLIT-RECEIPTING GUIDELINES

1. The Four Key Elements

Technical News No. 26 sets out four key elements to the new interpretative approach adopted by CCRA. These four elements are summarized below as follows:

- a) First, there must be a voluntary transfer of property with a clearly ascertainable value.
- b) Second, any advantage received or obtained by the donor, as defined in the newly inserted subsection 248(31) of the Act, must be clearly identified and its value ascertainable. In this regard, the donee will be required to identify the advantage provided to the donor by setting out the eligible amount of the gift in the charitable donation receipt issued by the donee charity in accordance with the newly proposed changes to section 3501 of the Income Tax Regulations. In relation to the issue of valuation of the advantage, the guidelines indicated that the donee charity should consider obtaining a qualified independent valuation of the amount of the advantage on the donor.
- c) Third, there must be a clear donative intent by the donor to give property to the donee. In this regard, paragraph 248(32)(a) of the Act provides that if the amount of the advantage does not exceed 80% of the fair market value of the transferred property, then the fact that the donor obtained an advantage from the donee charity will not necessarily disqualify the transfer from being qualified as a gift. Where the amount of an advantage exceeds 80% of the fair market value of the transferred property, paragraph 248(32)(b) of the Act provides that the donor can establish to the satisfaction of the Minister of National Revenue that the transfer was made with the intention to make a gift, i.e. the onus is placed upon the donor instead of there being a presumption of a gift.
- d) Fourth, the new subsection 248(30) of the Act defines the “eligible amount of a gift” to be the amount by which the fair market value of the gift exceeds the amount of the advantage provided to the donor. In this regard, CCRA is prepared to administratively provide for a de minimis threshold that will simplify matters for both donors and donees where advantages provided to the donors are of insignificant value. The current version of Interpretation Bulletin IT-110R3, “Gifts and Official Donation Receipts,” provides that no benefit of any kind may be provided to a donor except where the benefit is of nominal value, i.e. where the fair market value of the benefit does not exceed the lesser of \$50 or 10% of the amount of the gift. This de minimis threshold will be revised to provide that the amount of the advantage received by the donor that does not exceed the lesser of 10% of the value of the property transferred to the charity and \$75 will not be regarded as an advantage for purposes of determining the eligible amount of the gift set forth in the proposed definition.

However, CCRA indicated that the revised de minimis threshold would not apply to cash or near cash advantages, such as redeemable gift certificates, vouchers, coupons. In this regard, CCRA's position on circumstances where official donation receipts for income tax purposes can be issued for gift certificates is set out in Policy Statement, CPS-018, "Donations of Gift Certificates," that was issued on October 9, 2002.

2. Various Fundraising Events and Activities

CCRA indicated that the manner in which the eligible amount of a gift, as well as the amount of the advantage, are to be determined with regard to the nature of the various situations and fundraising events or activities, especially in situations where there is not a readily available market value comparison of the advantage. The following situations are discussed in the guidelines: fundraising dinners, charity auctions, lotteries, concerts, shows and sporting events, golf tournaments, and membership fees.

In general, the following are to apply when determining the value of the advantage and the eligible amount in the various fundraising events and activities:

- ♦ The eligible amount of a gift at a fundraising event is the amount of the ticket price paid by a participant, less the amount of advantage received by the participant, provided that the amount of the advantage is not more than 80% of the ticket price and the value of any advantage received by the participant can be reasonably quantified. In this regard, the position of CCRA as set out in IT-110R3 that no part of the cost of a lottery ticket may be considered as a gift continues to be applicable because it is not possible to reasonably quantify the amount of the advantage.
- ♦ The attendance of celebrities at fundraising events will not be viewed as an advantage. However, any incremental amount paid for the right to participate in an activity (e.g. dinner, golf etc.) with a particular individual would not be viewed by CCRA as a gift.
- ♦ When determining the value of the advantage received by the participants, there are two elements:
 - i) The de minimis rule will not be applied towards the value of the activity that is the object of the fundraising event (e.g. the value of a meal at a fundraising dinner, the value of a comparable ticket for a concert, or the value of green fee, cart rental, and meal at a golf tournament etc.) For example, if a participant paid \$200 for a ticket to attend at a fundraising dinner at which the value of the meal is \$100, then the amount of \$100 will be included when calculating the value of advantage received by the participant.
 - ii) The value of complementary benefits provided to all participants for attending the events and the value of door and achievement prizes that all attendees are eligible for by simply attending the events will be included in calculating the value of the advantage, unless the aggregate

value of these items allocated on a pro rata basis to all participants (i.e. per ticket sold) does not exceed the *de minimis* threshold, i.e. does not exceed the lesser of 10% of the ticket price and \$75. In other words, if such value of the benefits is below the *de minimis* threshold, then such value will not be included when calculating the value of the advantage received by the participants.

For example, assume in the above scenario of a fundraising dinner, each participant receives a logo pen and key chain with an aggregate value of \$10, and each participant is eligible for door prizes of a trip having a value of \$3,000 and jewellery having a retail value of \$500. If there were 500 participants, then the average value of the door prizes per participant is \$7. As a result, the aggregate value of the complementary benefits and door prizes is \$17 per participant. When applying the *de minimis* rule to the \$17 benefit, since the aggregate value is below the threshold value of \$20 (i.e. the lesser of \$75 or 10% of \$200), the amount of \$17 will not be included when calculating the value of the advantage. As a result, in the above example, the amount of advantage would only be the value of \$100 for the meal with the eligible amount of the gift being \$100, i.e. \$200 ticket price less the \$100 advantage. However, if the total value of the pen and the key chain is increased to \$20, then the aggregate value of the complementary benefits and door prizes would similarly be increased from \$17 to \$27, which would exceed the *de minimis* threshold of \$20. As such, the value of the advantage increases to \$127 instead and the eligible amount of the gift is reduced to \$73, being the \$200 ticket price less the \$127 advantage.

The application of these key elements in conjunction with the above general principles varies with the specific situations of fundraising dinners, charity auctions, lotteries, concerts, shows and sporting events, golf tournaments, and membership fees. Reference should be made to Technical News No. 26 for details concerning the application of these rules.

3. Charitable Annuities

As a result of the amendment to the definition of gift for income tax purposes, CCRA has withdrawn its administrative position with regard to charitable annuities set out in Interpretation Bulletin IT-111R2, "Annuities Purchased From Charitable Organizations," issued on September 22, 1995 and revised on February 10, 1997, which have now been archived. Pursuant to Technical News No. 27 that was

released on April 17, 2003, archived Interpretation Bulletins include those that are either no longer relevant due to changes in the law or changes in CCRA's interpretation of the law, as well as those that are seldom used, either because of the subject matter is covered in other CCRA publications or because the information presented is no longer of interest.

CCRA indicated in Technical News No. 26 that the previous administrative position with regard to charitable annuities has no basis in law and cannot be continued as a consequence of the amendment to subsection 248(33) of the Act. Rather, a new administrative policy has been proposed which can most easily be explained by the following example:

- Facts:
- A donor makes a \$100,000 contribution to a charitable organization
 - The donor's life expectancy is 8 years (and the donor lives 8 years)
 - The donor is to be provided annuity payments of \$10,000 per year (total of \$80,000)
 - The cost of the annuity to provide the \$80,000 payment over 8 years is \$50,000

Former tax treatment under IT-111R2

- The donor receives a tax receipt of \$20,000 for the year of donation, being the amount of \$100,000 in excess of the annuity payments of \$80,000
- All of the \$80,000 annuity payments are tax-free

Proposed tax treatment under Technical News No. 26

- The donor receives a tax receipt of \$50,000 for the year of donation, being the amount of \$100,000 in excess of the \$50,000 cost to provide the annuity
- \$30,000 of the \$80,000 annuity payments will be included as income of the donor over 8 years, with the balance of the \$50,000 to be tax free

However, CCRA indicated that the administrative policy set out in IT-111R2 will continue to apply to annuities that were issued prior to December 21, 2002. The expectation of CCRA that, notwithstanding the withdrawal of this administrative policy, "*charitable annuities are likely to continue as a means of fund raising, and may well be more advantageous to the donor*" remains to be seen.

4. Mortgaged Properties

When property that is subject to a mortgage is transferred to a charity, it will now be necessary to determine the fair market value of the property. In this regard, all relevant factors, including all

encumbrances, will need to be considered. When determining the eligible amount of the gift, the terms and conditions of the mortgage will need to be considered in determining the amount of the advantage received by the donor, which advantage will take the form of the donor being relieved of the indebtedness of the mortgage. This means that the implications of a “favourable” or “unfavourable” mortgage must also be reflected in the amount of advantage received by the donor.

The meaning of a “favourable” or “unfavourable” mortgage is best illustrated by an example provided by CCRA. If the value of the building, without reference to the mortgage, is \$1,000,000, and the value of the mortgage to be assumed by the charity receiving the building is \$400,000, and if the terms of the mortgage (e.g. interest rate and term) are representative of the current market conditions, then the eligible amount of the gift is \$600,000. However, if the terms of the mortgage are unfavourable (e.g. a high interest rate) such that the mortgagor would have to pay a third party \$450,000 in order to permit the mortgage be assumed by the charity, then the eligible amount would be reduced to \$550,000.

D. CONCLUDING COMMENTS

The definition of “gift” for purposes of the Act has now undergone a fundamental change (as explained in our Charity Law Bulletin No. 21) and the resulting technical implication of the new definition in the context of split receipting in practice is no less fundamental. In light of the proposed new guidelines that will apply to split-receipting as set out in Technical News No. 26, charities will need to give consideration to a number of factors prior to accepting and/or issuing an official donation receipt under the Regulations concerning the value of the property transferred, the value of the advantage received, and the value of the eligible amount of the gift. Where necessary, valuation by a qualified valuator may be necessary. The new rules are a welcome relief but need to be carefully followed to ensure that the charitable status of the donee charity would not be lost due to improper issuance of charitable donation receipts.