
CHARITIES DIRECTORATE PROVIDES GUIDANCE ON GIFTS IN KIND

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A. INTRODUCTION

The “*Registered Charities Newsletter, No. 18*” (“*Newsletter*”), dated March 29, 2004, from the Canada Revenue Agency (formerly Canada Customs and Revenue Agency) (“CRA”) focuses on receipting issues concerning gifts in kind, as well as a commentary on charitable donation tax shelter arrangements. Issuing receipts for gifts in kind requires that a charity be knowledgeable in valuation procedures and standards, as well as the impact of gifts on the overall disbursement quota of a charity. This issue requires careful consideration by a charity and its board of directors, as failure to properly assess and consider the tax consequences of a gift in kind may lead to penalties, including possible revocation of a charity’s status as a registered charity. This *Charity Law Bulletin* (“*Bulletin*”) provides a brief review of the directives given by CRA on gifts in kind as provided in the *Newsletter*, which is available at <http://www.cra-adrc.gc.ca/E/pub/tg/charitiesnews-18/news18-e.html>.

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B. GIFTS IN KIND

1. What is a Gift in Kind?

A gift is defined at common law as a voluntary transfer of property for which the donor receives nothing of value in return for having made the gift. Most charities are accustomed to receiving gifts in the form of cash. A gift in kind involves the voluntary transfer of property other than cash to a charity, but does not include the provision of services to a charity. A charity that receives a gift in kind will generally issue a tax receipt for the fair market value (“FMV”) of the gift, subject to certain exceptions described below.

While the line between what constitutes a property and what constitutes a service is generally clear, the Income Tax Rulings Directorate (“ITRD”) is currently considering scenarios where the distinction is less obvious, either because there is a question concerning whether the gift is of property or a service, or because there is a question whether the donor can be considered to have transferred property to the charity. For example, the ITRD is considering whether a web site can be considered property for the purposes of making a gift, and whether a licence to use software can be the subject of a gift. As well, the ITRD is looking at the tax implications of transferring reward points to a charity. At present, such proposed transactions will be considered on a case-by-case basis. The ITRD welcomes comments and submissions from the public by June 30, 2004, concerning whether these or other items can be the subject of a charitable tax receipt.

2. Calculating a Charity’s Disbursement Quota

The disbursement quota is a formulated amount specified under the *Income Tax Act* (“ITA”) that a registered charity must spend each year on its charitable activities, including gifts to qualified donees. Failure to expend the applicable disbursement quota on charitable activities will result in a disbursement shortfall. A charity can draw upon disbursement excesses accumulated over the past five years to cover this shortfall, or spend enough in the following year to make up the disbursement shortfall. However, continual disbursement shortfalls may lead to the revocation of a charity’s charitable registration.

Currently, the CRA requires that an amount equal to 80% of all receipted amounts from the previous year, other than a gift received from a registered charity,¹ must be included in calculating the amount of the charity's disbursement quota. Amounts in respect of gifts of capital received by way of bequests or inheritance and "10 year gifts" are only to be included in the year they are expended. Gifts, other than specified gifts, received from a registered charity are to be included in the disbursement quota in an amount equal to 100% for a private foundation and 80% for a public foundation, whether the gift is in cash or in kind.

The CRA is prepared to accept that the necessary amount of the disbursement quota has been expended where the property is used directly by the charity in delivering its charitable programs. For example, CRA takes the position that paintings donated to an art gallery for use in its display would be considered to have been expended on charitable activities, whereas gifts in kind received for a fundraising auction would not be considered expended until they are converted to cash and used by the charity in carrying on its charitable activities.

3. Calculating the Eligible Amount of a Gift In Kind

A gift in kind must be valued at its FMV, with the exception of tax shelter donation arrangements described below. FMV has been defined by the courts as "the highest price obtainable in an open and unrestricted market between informed and prudent parties, acting at arm's length, under no compulsion to act, expressed in terms of money, or money's worth." The CRA recommends employing the services of an independent appraiser or valuator to determine the FMV if the value of the property donated is anticipated to be greater than \$1,000.

The CRA advises that in order to determine the FMV of property, an individual requires a knowledge of the property being appraised or valued and a specialized knowledge of the principles, theories and procedures of real estate appraisal, business equity valuation, personal property, machinery and equipment valuation, or other valuation specialties. As such, it is important to obtain the services of a qualified individual in the appropriate specialty area to obtain a supportable, well-reasoned opinion of

¹ This exception is to be eliminated as a result of the 2004 Budget.

value. When completing a valuation of a gift in kind, an accredited appraiser or valuator is required to follow the Canadian Uniform Standards of Professional Appraisal Practice, or the Practice Standards established by the Canadian Institute of Chartered Business Valuators.

The above comments about valuing gifts in kind at FMV are subject to recent amendments to the *ITA* dealing with tax shelter donation arrangements. As discussed in previous *Bulletins* and articles available at <http://www.charitylaw.ca>, the Department of Finance issued proposed amendments to the *ITA* on December 5, 2003, which were revised on February 27, 2004, and which significantly changes the rules with regard to gifts in kind involving tax shelter donation arrangements. These arrangements resulted from what is termed “buy-low, donate-high” schemes, through which different kinds of property (e.g. pharmaceutical products, food items, computers, books, etc.) could be purchased at a low price and then donated to a charity at a considerably higher price, resulting in a tax receipt for an amount that was substantially higher than the actual cost of the property to the donor. The December 5, 2003 draft amendments to the *ITA*, revised on February 27, 2004, generally limit tax benefits from charitable donations under tax shelter donation arrangements to the lesser of the FMV of the property and the cost of acquisition of the property by the donor.² However, gifts of inventory, publicly traded securities, certified cultural property, ecological gifts, or real property situated in Canada are exempted from these new provisions.

The CRA is in the process of reviewing transactions involving charitable donations in tax shelter arrangements and may challenge claims where amounts on receipts seem inflated. Charities and promoters involved in such arrangements may be subject to civil penalties under the *ITA* if they make misrepresentations of tax matters that could result in their clients making false statements or omissions on their tax returns, including overstating the FMV of donated property.

² For more information on the amendments affecting tax shelter donation schemes, see *Charity Law Bulletin* No. 30 (16 December 2003, revised 17 February 2004)), *Charity Law Bulletin* No. 38 (19 February 2004), *Charity law Bulletin* No. 40 (29 March 2004), available at <http://www.charitylaw.ca>; Terrance S. Carter and Theresa L.M. Man, “Recent Changes to the Income Tax Act and Policies Relating to Charities and Charitable Gifts” (Paper presented to Society of Trust and Estate Practitioners, March 2004, revised May 11, 2004), available at <http://www.charitylaw.ca>.

4. Special Receipting Considerations

a) Donation of Time-Shares, Including Recreational Property

Donation of a time-share or other recreational property will only be entitled to a receipt if ownership of the deed title is first transferred to the donor and then transferred to the charity. Merely loaning property is not considered a gift for purposes of sections 110.1 and 118.1 of the *ITA*. Any capital gains realized at the time of the donation would be taxable in the donor's hands in the usual way. Charities would not be required to establish a value of the interest if the donors were to dispose of the property themselves and then make a gift of the proceeds.

b) Donation of Business Inventory

Charities can issue official donation receipts for gifts of business inventory, and the business may use these receipts to claim a charitable deduction. However, businesses that donate inventory to a registered charity must include the FMV of the goods in its income. This increase is offset by the charitable deduction or credit. Where a transaction results in a material benefit to the business, the new split-receipting rules may apply,³ or the benefit may be such that no part of the transaction can be considered a gift. The CRA indicates that in cases where there is consideration, a business may claim these costs as promotional expenses, rather than seeking a charitable donation receipt.

c) Transfer of Shares or Stock Options

Canadian courts have held that where a corporation issues shares of its capital stock or grants a stock option in its stock, such transfer does not constitute a gift for the purposes of the *ITA*. This is because there is no transfer of property by the corporation as the corporate assets are not reduced as a result of the issuance. However, if the donor is a person, the charity may issue a receipt for the transfer of shares or stock options.

³ For more information on CRA's guidelines on split-receipting, see *Charity Law Bulletin* No. 23 (31 July 2003), *Charity Law Bulletin* No. 38 (19 February 2004), *Charity law Bulletin* No. 40 (29 March 2004), available at <http://www.charitylaw.ca>; Terrance S. Carter and Theresa L.M. Man, "Recent Changes to the Income Tax Act and Policies Relating to Charities and Charitable Gifts" (Paper presented to Society of Trust and Estate Practitioners, March 2004, revised May 11, 2004), available at <http://www.charitylaw.ca>.

d) Court Ordered Payments to a Charity

Court ordered payments to a charity do not constitute a gift as the payment is not voluntary. This remains true even in cases where the taxpayer was given a choice between making the payment and some other form of penalty. A charity can, however, issue an ordinary receipt to acknowledge the payment, provided that the receipt is not used for purposes of claiming a tax credit.

C. OTHER MATTERS - UPCOMING POLICIES FROM THE CHARITIES DIRECTORATE

The *Newsletter* also indicates that the Charities Directorate plans to make available several new draft policies this year, including the long-anticipated policies on public benefit, ethnocultural organizations, and umbrella organizations. Copies of the draft publications will be made available on the "Consultation on proposed policy" page for charities on the CRA web site (http://www.cra-arc.gc.ca/tax/charities/consultation_policy-e.html).

D. CONCLUSION

Careful consideration should be given to the receipt of gifts in kind by a charity, since failure to do so may result in significant tax consequences and penalties, including possible revocation of the organization's charitable status. Charities and their boards of directors must pay special attention to issues of acceptable charitable receipting, the impact of gifts on charities' disbursement quotas, and the valuation of gifts, particularly in light of the December 5, 2003 proposed amendments to the *ITA*, revised on February 27, 2004, affecting charitable donation tax shelter arrangements.