CARTERS.ca

CARTER & ASSOCIATES
PROFESSIONAL CORPORATION
BARRISTERS, SOLICITORS & TRADE-MARK AGENTS
Affiliated with **Fasken Martineau DuMoulin** LLP

CHARITY LAW BULLETIN NO. 64

JANUARY 31, 2005

Editor: Terrance S. Carter

2004 CHARITY AND NOT-FOR-PROFIT LAW DEVELOPMENTS: THE YEAR IN REVIEW

By Terrance S. Carter, Carter & Associates
and M. Elena Hoffstein, Fasken Martineau DuMoulin LLP

A. INTRODUCTION

In 2004, there were numerous important legislative, regulatory and common law developments that significantly impact how charities operate in Canada and abroad. The following brief summary outlines some of the more important developments in this regard, including the new definition of gift for tax purposes, the new definition of charitable organization and public foundation, the new regulatory regime under the *Income Tax Act* (Canada) (the "ITA"), the new federal corporate legislation for non-share capital corporations, and proposed policy statements and publications from the Charities Directorate of Canada Revenue Agency ("CRA"), as well as a number of important court decisions.

B. TAX ISSUES

1. February 27, 2004 Income Tax Amendments

Draft amendments to the ITA, released on February 27, 2004, constitute a consolidation of, and further amendment to, previously proposed amendments introduced on December 20, 2002 and December 5, 2003. These draft amendments are collectively referred to as the "February 2004 Amendments" in the

following summary.[1] As of the end of January 2005, the February 2004 Amendments have not been passed by Parliament.

a) New Definition of Gift

At common law, a "gift" must be transferred voluntarily, without any contractual obligation or advantage of a material nature returned to the donor. The February 2004 Amendments introduce a new concept of "gift" for tax purposes to provide a tax benefit even when the donor receives an advantage, where the value of the property exceeds the advantage received. This new concept applies to gifts made after December 20, 2002.

b) New Definitions of Charitable Organization and Public Foundation

The ITA currently requires that not more than 50% of the capital contributed to a charitable organization or public foundation can be contributed by one donor. This is usually referred to as the "contribution" test. The February 2004 Amendments propose to replace the "contribution" test with a new "control" test, permitting a charity to receive contributions of more than 50% of its capital from a person or a group of persons, provided that the donor(s) does not control the charity or represent more than 50% of the directors and trustees of the charity. This is retroactively applicable to January 1, 2000.

c) Tax Shelter Donation Deeming Provision

As a result of concerns raised by the public and CRA regarding "buy-low, donate-high" donation schemes providing donors with tax benefits, the February 2004 Amendments proposed changes to shut down such schemes. The ITA will be amended to provide that if a taxpayer acquires property through a "gifting arrangement" as defined in the ITA, then the fair market value ("FMV") of the property donated, regardless of when the property was acquired, shall be "deemed" to be the lesser of (i) the FMV of the property and (ii) the cost of the property to the taxpayer immediately before the gift is made (the "Deeming Provision"). The Deeming Provision

[1] For more information, see Terrance S. Carter and Theresa L.M. Man. "February 27, 2004, Revised Draft Amendments to the *Income Tax Act* Affecting Charities." *Charity Law Bulletin* No. 40 (March 29, 2004). www.carters.ca.

does not apply to inventory, real property situated in Canada, certified cultural property, publicly traded shares or ecological gifts. These amendments will apply to gifts made on or after 6 p.m., December 5, 2003.

d) Other Applications of the Deeming Provision

The Deeming Provision will also apply (1) if a donor acquires property and donates the property within three years of the date of acquisition, and (2) if it is "reasonable to conclude" that the donor intended to make a gift when the property was acquired, regardless of when the donor acquired the property. The burden is on the donor to prove there was no intention to make a gift when the property was acquired. The Deeming Provision does not apply to situations where a gift is made as a consequence of the donor's death. These amendments apply to gifts made on or after 6 p.m. on December 5, 2003. Application of the proposed Deeming Provision will have serious practical implications concerning how charities accept gifts and issue donation receipts, including possibly requiring donors to provide written confirmation of when donated property was acquired.

e) Restricting the Use of Limited Recourse Debt

The February 2004 Amendments also introduced provisions to curtail gifting arrangements involving limited-recourse debts incurred by donors by reducing the amount of the gift by the amount of the loan if the indebtedness is of limited recourse to the lender or if there is a guarantee, security or similar indemnity or covenant with respect to that debt or any other debts. These amendments will apply to donations made after February 18, 2003.

f) Substantive Gift

The February 2004 Amendments propose to include a new subsection that applies to gifts of capital property and eligible capital property (referred to as "substantive gifts") made on or after February 27, 2004, to prevent donors from avoiding application of the Deeming Provision by disposing of property to a qualified donee and then donating the proceeds of disposition to either that qualified donee or to another qualified donee who does not deal at arm's length with the

qualified donee that purchased the property, rather than donating the property directly to the qualified donee. Under these situations, the Deeming Provision will apply and the FMV of the substantive gift and the proceeds of sale would be "deemed" to be the lesser of the FMV of the gift and the cost of the property to the taxpayer immediately before the sale of the property.

g) New qualified donee

The February 2004 Amendments also propose to expand the list of "qualified donees" to include municipal or public bodies performing a function of government in Canada.

2. December 6, 2004 Income Tax Amendments[2]

Draft income tax amendments implementing the 2004 Federal Budget were released on September 16, 2004, and further amended and consolidated by a *Notice of Ways and Means Motion* tabled by the Minister of Finance in the House of Commons on December 6, 2004 (the "December 2004 Amendments"), which received first reading on December 8, 2004 and, on December 14, 2004, was moved to be read a second time and referred to committee. These amendments introduce a new regulatory regime for charities, new intermediate sanctions, a more accessible appeals regime, improved transparency and more accessible information, as well as new disbursement quota rules for charities. The December 2004 Amendments generally apply to taxation years beginning after March 22, 2004, with some exceptions being in effect 30 days after Royal Assent. The December 2004 Amendments do not affect the changes embodied in the February 2004 Amendments.

a) New intermediate sanctions

To provide an alternative to revocation of charitable status for minor or unintended infractions, the December 2004 Amendments introduce intermediate sanctions. These sanctions include taxation of gross revenue derived from business activities, suspension of tax-receipting privileges, monetary penalties, and taxation of gifts and transfers to other registered charities. Some sanctions are progressive, increasing in severity for repeat infractions within a period of 5 years.

[2] For more information, see Terrance S. Carter and Theresa L.M. Man. "December 2004 Amendments to the *Income Tax Act* Affecting Charities." *Charity Law Bulletin* No. 61 (January 12, 2005). www.carters.ca.

b) Annulment and revocation

The December 2004 Amendments provide the Minister with explicit authority to annul an organization's registration if it was registered in error or if it has ceased to be a charity "solely as a result of a change in law." Annulled organizations will be deemed not to have been registered at all and the Part V revocation tax will not apply, but official receipts issued prior to annulment will be accepted as valid. The Minister retains the right to revoke the registration of a charity in the event of severe breaches of the ITA. The December 2004 Amendments also require the assets of a charity whose registration has been revoked be transferred to the more limited list of entities that qualify as "eligible donees," rather than to the full list of qualified donees.

c) Appeals

The December 2004 Amendments propose to make the appeal process more accessible and affordable for registered charities and unsuccessful applicants for charitable status. CRA's internal review process is proposed to be extended to notices of a decision by the Minister regarding the revocation or annulment of a charity's registration, designation of a charity as a private or public foundation or charitable organization, denial of applications for charitable status, and imposition of taxes or penalties against a registered charity. Appeals of decisions concerning refusals to grant registered charitable status and revocation of registered charitable status will continue to be made to the Federal Court of Appeal, while taxes and penalties will be appealed to the Tax Court of Canada.

d) Transparency and accessibility of information

The December 2004 Amendments propose to authorize the Minister to release additional information to the public, including grounds for revocation or annulment; financial statements; decisions of CRA regarding notices of objection; identification of registered charities subject to sanctions, the type of sanction imposed, and grounds for the sanction; information to support an application by a registered charity for special status or an exemption under the ITA (e.g. request for permission to accumulate assets); and reasons for denying the registration of organizations.

Further, official donation receipts issued after 2004 will be required to include the current internet address of CRA.

e) New disbursement quota rules

The December 2004 Amendments propose to reduce the 4.5% disbursement quota that applies to public and private foundations to a more manageable rate of 3.5%. The disbursement quota reduction applies to taxation years that begin after March 22, 2004.

Only public and private foundations have previously been subject to a disbursement quota on capital assets not used in charitable activities or administration. However, the December 2004 Amendments propose that the reduced 3.5% disbursement quota also apply to charitable organizations. The reduced disbursement quota rate of 3.5% on investment assets will apply to a registered charity only if the value of its investment assets exceeds $25,000.

A new concept of "enduring property" was introduced, which includes gifts received by way of a bequest or inheritance (including gifts of life insurance proceeds, RRIFs and RRSPs as a result of direct beneficiary designation), ten-year gifts received by a charity, and gifts received by a charity as the transferee of an enduring property.

In general terms, a charity will be permitted to encroach on the capital gains of enduring property up to a maximum of the lesser of 3.5% of the charity's investment assets and its "capital gains pool," which is the realized capital gain from the disposition of enduring property, as declared by the charity on its T3010 Information Return.

Transfers from registered charities to charitable organizations were previously exempt from the 80% disbursement quota. The December 2004 Amendments propose that all transfers from one registered charity to another will be subject to the 80% disbursement requirement, except those involving specified gifts and enduring property.

Although many aspects of the proposed new disbursement quota rules reflect an attempt by the Department of Finance to address a number of problems facing charities, the complexities introduced are such as to make them more difficult, if not impossible, for the average charity to

understand, let alone comply with. In addition, there are concerns about the proposed 3.5% disbursement quota being extended from charitable foundations to charitable organizations and the exemption of transfers of capital to charitable organizations from other registered charities being removed. This represents a major change in tax policy that will blur the line between public foundations and charitable organizations.

C. PROPOSED POLICIES FROM CANADA REVENUE AGENCY[3]

1. Applicants Assisting Ethnocultural Communities

In September 2004, the CRA released a proposed policy statement dealing with "Applicants Assisting Ethnocultural Communities." The proposal sets out detailed guidelines on attaining charitable status for community organizations that assist disadvantaged ethnocultural communities in Canada. Based on the policy statement, an ethnocultural group is defined by the shared characteristics that are unique to, and recognized by, that group. Some examples of shared characteristics are ancestry, language, country of origin, and national identity. According to CRA, assisting ethnocultural communities is distinct from promoting multiculturalism, which lacks the necessary element of altruism to enable it to qualify as a charitable purpose.

As a starting point, organizations that assist ethnocultural groups and wish to acquire charitable status must qualify under one, or a combination, of the four heads of charitable purposes established by the House of Lords decision in *Special Commissioners of Income Tax v. Pemsel*.[4] These are "relief of poverty," "advancement of education," "advancement of religion," and "other purposes beneficial to the community." The policy statement provides examples of acceptable, as well as unacceptable ethnocultural work under these categories. However, the activities that qualify as unacceptable ethnocultural work under the heads of "relief of poverty" and "advancement of religion" are not clearly articulated and lack the certainty that prospective charities may require.

[3] The proposed policy statements and publication are available at the CRA website: http://www.cra-arc.gc.ca/menu-e.html.
[4] [1891] A.C. 531 (H.L.).

2. Guidelines for Meeting the Public Benefit Test

In September 2004, CRA released another proposed policy statement on "Meeting the Public Test," which seeks to clarify the rules relating to the requirement of "public benefit" – one of the criteria all applicants must meet in order to be considered "charitable" at common law. The guidelines propose a two-part public benefit test requiring proof that a tangible benefit is being conferred and that the benefit has a public character.

Currently, charities qualifying under the first three categories are presumed to be for the public benefit. However, based on this proposal, the current presumption would be open to challenge. This introduction of a rebuttable presumption of public benefit represents one of the more controversial aspects of the proposal, as it introduces a lack of clarity regarding whether particular activities will satisfy the public benefit test, as well as the risk of narrowing the common law definition of charity.

3. Charities in the International Context

In light of increased focus on the international activities of charities since September 11, 2001, and the introduction of several pieces of legislation as part of Canada's anti-terrorism initiatives, the CRA released "Charities in the International Context" in September 2004, providing operational guidance to Canadian charities operating abroad. This publication affirms that charities operating abroad continue to fall under the jurisdiction of Canadian statutory and regulatory authorities. It also identifies sources of information that address the statutory and regulatory boundaries within which charitable activities must be carried out. The sources of information identified include ITA rules, CRA guidelines, and international best practice standards. These sources provide charities with guidance on ensuring their resources are used for legitimate charitable purposes. The stated rationale behind this approach to regulating the activities of charities in the international context is to maintain public confidence in the charitable sector, ensure the integrity of the registration granting process and ensure that the tax benefits reserved for Canadian charities are not used to provide support to terrorism in the guise of charity.

D. OTHER LEGISLATIVE INITIATIVES AFFECTING CHARITIES

1. Proposed *Canada Not-For-Profit Corporations Act*[5]

On November 15, 2004, the *Canada Not-For-Profit Corporations Act* ("Bill C-21") (the "CNFPCA") received first reading in the legislature. The CNFPCA will replace Parts II and III of the *Canada Corporations Act* (the "CCA") – the current corporate governance statute, with a modern corporate governance framework for the regulation of federally incorporated not-for-profit corporations. Existing not-for-profit corporations must apply for continuance under the CNFPCA within three years of it coming into force. The CNFPCA was modelled on provisions of the *Canada Business Corporations Act*, as well as salient provisions of provincial not-for-profit statutes and was benchmarked against similar legislation in the Unites States.[6] Consultations will be ongoing while the Bill is being considered by Parliament.

The CNFPCA proposes many changes from the current governance provisions in the CCA, including:

- streamlined "as of right" process for incorporation upon filing of required forms and payment;
- amended requirements for articles of incorporation and by-laws of not-for-profit corporations;
- office of director of corporations created with regulatory and investigative powers;
- Directors' duties and responsibilities outlined, an objective standard of care and a due diligence defence as well as other protections for directors and officers established;
- rights of members enhanced and protected;
- faith-based defences provided against both derivative actions and claims of oppressive or prejudicial conduct by a religious not-for-profit corporation;
- categories of soliciting corporations (those which solicit public donations or government funding) and non-soliciting corporations introduced, with graduated levels of financial review based upon a corporation's category and gross annual revenue; and
- not-for-profit corporations will now be required to make financial statements available to members, directors and officers of the corporation, as well as to the new Director of Corporations.

[5] For more information, see Jacqueline M. Connor and Terrance S. Carter. "New *Canada Not-For-Profit Corporations Act* and its Impact on Charitable and Non-Profit Corporations." *Charity Law Bulletin* No. 60 (December 30, 2004). www.carters.ca.

[6] See 38th Parliament 1st Session, Edited Hansard, Number 030. Available at: http://www.parl.gc.ca/38/1/parlbus/chambus/house/debates/030_2004-11-23/toc030-E.htm

Corporations that are incorporated or continue under the CNFPCA stand to benefit from the governance framework proposed in it.

2. *Charitable Purposes Preservation Act* (British Columbia)

The *Charitable Purposes Preservation Act* (British Columbia) is a legislative response to the decision in *Christian Brothers of Ireland In Canada*[7] (CBIC), in which the courts found that property held in special purpose charitable trusts can be seized by a creditor to satisfy debts owed to tort claimants, even if those claims arise from circumstances unrelated to the trust in question. The CBIC decision increased the legal uncertainty about when charitable donations given in trust are, or ought to be, preserved from being used to satisfy debts and other liabilities of the charity. To address this concern, British Columbia's Act supplements the law of trusts, as it relates to charitable giving, by expressly recognizing and protecting discrete purpose gifts and setting out the obligations such gifts impose on recipient charities and the courts.

3. Uniform Law Conference of Canada Position Paper on Charitable Fundraising

In April 2004, the Uniform Law Conference of Canada, Civil Law Section, (ULCC) released a position paper on "Charitable Fundraising." The resulting draft *Uniform Charitable Fundraising Act*, expected by August 2005, is anticipated to affect charities across Canada, by addressing instances of fraudulent, inept and unethical fundraising practices by charities and fundraising businesses. Professor Oosterhoff, the author, points out that although these infractions are not rampant in the sector, they stand to undermine the integrity of the sector if allowed to continue unchecked.

[7] *Christian Brothers of Ireland in Canada (Re)* (1998), 37 O.R. (3d) 367 (Ont. Ct. (Gen. Div)), 21 E.T.R. (2d) 117, rev'd (2000), 47 O.R. (3d) 674 (Ont. C.A.); *Christian Brothers of Ireland in Canada (Re)*, (2000), 47 O.R. (3d) 674 (Ont. C.A.), rev'g (1998), 37 O.R. (3d) 367, application for leave to appeal to the Supreme Court of Canada dismissed, November 16, 2000; *Rowland* v. *Vancouver College Ltd.* (2000), 78 B.C.L.R. (3d) 87 (S.C.), 34 E.T.R. (2d) 60, aff'd (2001), 94 B.C.L.R. (3d) 249 (C.A.);

E. CASELAW

1. Freedom of Religion[8]

In *Syndicat Northcrest v. Amselem ("Amselem")*,[9] the Supreme Court of Canada rendered a broad interpretation of the Canadian Charter of Rights and Freedoms (the "Charter") right to religious freedom. Justice Iacobucci rejected the "unduly restrictive" view of freedom of religion taken by the Court of Appeal and stated that "freedom of religion" is triggered when a claimant demonstrates that he or she sincerely believes in a practice or belief that has a nexus with religion." In addition, he stated that "it is not within the expertise and purview of secular courts to adjudicate questions of religious doctrine." As well, there should be no legal distinction between "obligatory" and "optional" religious practices.

The Supreme Court decision in *Amselem* establishes that it is the spiritual essence of an action that is sincerely held, and not the mandatory nature of its observance, that attracts protection. Further, the decision reinforces that it is inappropriate for courts to decipher contentious matters of religious law. Together, these principles expand the scope of protected freedom of religion to practitioners of a faith, and not just to believers of a faith.

In *Congregation des Temoins de Jehovah de St-Jerome-Lafontaine v Lafontaine (Village)*[10] the Supreme Court of Canada did not allow the religious congregation's appeal on the grounds that the Municipality infringed the congregation's religious rights by denying the rezoning application that would allow the congregation to build a place of worship. Rather, the appeal was granted on the grounds that the municipality breached its duty of procedural fairness to the congregation in refusing to provide reasons for its decisions.

[8] For more information, see Terrance S. Carter. "Supreme Court of Canada Adopts Broad View of Religious Freedom." *Charity Law Bulletin* No. 51 (August 23, 2004). www.carters.ca.
[9] [2004] S.C.J. No. 46.
[10] [2004] S.C.J. No. 45

2. Activities Must Further Charitable Purpose

In *Fuaran Foundation v. Canada Customs Revenue Agency*,[11] although the Foundations' listed objectives focused on the advancement of religion, the court was not convinced that their activities were exclusively for the purpose of advancing religion. The court ruled that it was reasonable for CRA to deny registration because the objects were overly broad and could allow for non-charitable activities, as attendees at the Retreat Centre could chose not to participate in religious activities.

3. Revoking Charitable Status

In *College Rabbinique de Montreal Oir Hachaim D' Tash v Canada (the College),*[12] the court endorsed the CRA's decision to revoke the appellant's charitable registration for not complying with the ITA rules as follows:

(a) providing donation receipts for amounts that were not gifts;
(b) not devoting all its resources to charitable purposes and activities;
(c) failing to maintain proper books and records; and
(d) making improper loans.

4. Property Tax Exemption

In *Ottawa Salus Corporation v. Municipality Property Assessment Corporation et al* the Ontario Court of Appeal, endorsed the Divisional Court finding that the word "occupy" under the *Assessment Act* (Ontario) is not limited in its ordinary meaning to physical occupation. The court interpreted the word "occupy" in relation to the organization's purpose to relieve poverty and held that, since the tenants were the recipients of the charity's work to relieve poverty, "occupation" for the purposes of the exemption did not require actual or exclusive occupation by the charitable institution.

Two points can be drawn from this decision. First, actual "occupation" must be interpreted more expansively when viewed in relation to an organization whose purpose is relief of poverty. Secondly,

[11] 2004 FCA 181
[12] [2004] F.C.J. No. 424

the decision emphasizes that in assessing "occupation," there must be a nexus between the occupants of the property and the organization's objects in order to qualify for tax exempt status.

5. Enforcing Donor Pledges[13]

The decision in *Brantford General Hospital Foundation v. Marquis Estate*[14] reinforces the long standing common law principle that a pledge is unenforceable for lack of consideration. Further, the doctrines of part performance and estoppel will only allow enforcement of a pledge in cases where there is a pre-existing legal or contractual relationship between the parties. Two implications can be drawn from the decision. First, there should be a correlation between testamentary and *inter vivos* gifts. In drafting a will, it is important that legal counsel ensure the testamentary gift will continue to honour the *inter vivos* gift and allow for the testator's wishes to be fulfilled. Secondly, the case reinforces that a pledge is not a binding contract, as, to be enforceable, a pledge must be accompanied by consideration.

6. Cy pres[15]

In *Toronto Aged Men's and Women's Homes v. Loyal True Blue and Orange Home,*[16] the court exercised its inherent *cy pres* jurisdiction to alter the terms of a charitable trust to address the Trust's inability to meet its disbursement quota due to the rate of return on its capital assets. This decision confirms that the terms of a charitable trust may be varied when the conditions for an application of the *cy pres* jurisdiction are satisfied, namely that the purposes of the Trust have become impossible or impracticable to achieve if it is to continue to be administered in accordance with the provisions of the Trust.

7. Commercial Activity by a Non-Profit Organization

In *Rodgers v. Calvert,*[17] the courts found that the mere exchange of consideration in a contract does not, in itself, lead to the finding of commercial activity under PIPEDA. Furthermore, the court found it

[13] For more information, see Terrance S. Carter. "Ontario Superior Court of Justice Reaffirms Unenforceability of Pledges." *Charity Law Bulletin* No. 49 (July 30, 2004). www.carters.ca.
[14] (2003), 67 O.R. (3d) 432 (Sup. C.J.)
[15] For more information, see Terrance S. Carter and Nancy E. Claridge. "*Cy Pres* Granted to Enable Charitable Trust to Meet Disbursement Quota." *Charity Law Bulletin* No. 53 (September 28, 2004). www.carters.ca.
[16] [2003] O.J. No. 5381
[17] [2004] O.J. No. 3653

unfeasible to set out criteria or facts defining "commercial activity" for a non-profit organization. As a result, this decision provides no further judicial clarity concerning whether PIPEDA applies to charitable organizations or what activities will be construed as "commercial activities" triggering the disclosure protections under PIPEDA.

CARTERS.ca

CARTER & ASSOCIATES
PROFESSIONAL CORPORATION
BARRISTERS, SOLICITORS & TRADE-MARK AGENTS
Affiliated with **Fasken Martineau DuMoulin** LLP

Main Office Location
211 Broadway, P.O. Box 440
Orangeville, ON, Canada, L9W 1K4
Tel: (519) 942-0001
Fax: (519) 942-0300
Toll Free: 1-877-942-0001
www.carters.ca

National Meeting Locations
Toronto (416) 675-3766
Ottawa (613) 212-2213
London (519) 937-2333
Vancouver (877) 942-0001
"Proactive Advice" ®
www.charitylaw.ca

DISCLAIMER: This is a summary of current legal issues provided as an information service by Carter & Associates. It is current only as of the date of the summary and does not reflect subsequent changes in the law. The summary is distributed with the understanding that it does not constitute legal advice or establish the solicitor/client relationship by way of any information contained herein. The contents are intended for general information purposes only and under no circumstances can be relied upon for legal decision-making. Readers are advised to consult with a qualified lawyer and obtain a written opinion concerning the specifics of their particular situation.

© 2005 Carter & Associates