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CHARITY LAW BULLETIN NO. 76

SEPTEMBER 8, 2005
REVISED FEBRUARY 3, 2006
Editor: Terrance S. Carter

JULY 18, 2005 DRAFT AMENDMENTS TO THE *INCOME TAX ACT* AFFECTING CHARITIES: PART I – DEFINITION OF GIFT & SPLIT-RECEIPTING

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A. INTRODUCTION

On July 18, 2005, the Department of Finance (the "Department") again released legislative proposals (the "July 2005 Amendments") to amend the *Income Tax Act* (Canada) (the "Act"). The July 2005 proposal is a package of changes that consolidates and further amends previously proposed amendments introduced by the Department on December 20, 2002 (the "December 2002 Amendments"), December 5, 2003 (the "December 2003 Amendments") at 6 p.m., and February 27, 2004 (the "February 2004 Amendments"), as well as amending provisions enacted by Bill C-33, *A Second Act to Implement Certain Provisions of the Budget Tabled in Parliament on March 23, 2004* that came into force on May 13, 2005.[1]

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

[1] The effects of these changes have been summarized in the following *Charity Law Bulletins* and paper, all of which are available on our website at www.charitylaw.ca, and readers are encouraged to refer to them for more detail:

- December 2002 Amendments – See *Charity Law Bulletin* No. 21, "Commentary on Draft Technical Amendments to *the Income Tax Act* Released on December 20, 2002 that Affect Charities," dated April 30, 2003.
- December 2003 Amendments – See *Charity Law Bulletin* No. 30, "Tax Shelter Donation Schemes," dated December 16, 2003 and *Charity Law Bulletin* No. 38, "December 5, 2003 *Income Tax Act* Amendments Affecting Charities," dated February 19, 2004.
- February 2004 Amendments – See *Charity Law Bulletin* No. 40, "February 27, 2004 Revised Draft Amendments to the *Income Tax Act* Affecting Charities," dated March 29, 2004.
- Bill C-33 – See paper by M. Elena Hoffstein and Theresa L.M. Man, *New Disbursement Quota Rules Under Bill C-33*, presented at the Canadian Bar Association /Ontario Bar Association 3rd National Symposium on Charity Law on May 6, 2005.

and public foundations, revocation of charitable registrations, etc. These changes are summarized in a series of two *Charity Law Bulletins*. This *Bulletin* is Part I of the series, and summarizes the following changes concerning the definition of "gift" and split-receipting which are contained in subsections 248(30) to (41):

- Intention to give and "eligible amount" of gift
- Amount of advantage
- Cost of property acquired by donor
- Repayment of limited-recourse debt
- Deemed fair market value and non arm's transaction
- Anti-avoidance
- Substantive gifts
- Reasonable inquiry and information from donor

Other changes are summarized in *Charity Law Bulletin* No. 77, available on our website at www.charitylaw.ca. The Department's news release indicates that comments regarding the July 2005 Amendments can be forwarded to the Tax Legislation Division of the Department by September 15, 2005.

B. DEFINITION OF GIFT FOR INCOME TAX PURPOSES AND SPLIT RECEIPTING

Subsections 248(30) to (41) are proposed to be inserted in the Act to allow a donor to receive a donation tax receipt even in situations where the donor or someone else received a limited advantage as a result of the gift. This is referred to as "split-receipting."[2] Some of the proposed changes in this regard also stem

[2] Although these proposed changes have not been enacted, Canada Revenue Agency ("CRA") released *Technical News No. 26* on December 24, 2002, concerning proposed new rules for split-receipting which is premised on these proposed changes. Furthermore, the British Columbia Supreme Court in *Richert* v. *Stewards' Charitable Foundation* [2005] B.C.C.J. No. 279 up-held compliance with Technical News No. 26, as required by CRA. In this regard, CRA's *Registered Charities Newsletter* No. 17 specifically indicates that the proposed guideline in Technical News No. 26 "can be relied on now, despite the fact that the proposed legislation is not yet law." For details, please refer to the following *Charity Law Bulletins* available on our website at www.charitylaw.ca:

- *Charity Law Bulletin* No. 23, "New CCRA Guidelines on Split-Receipting," dated July 22, 2003; and
- *Charity Law Bulletin* No. 68, "B.C. Court Upholds CRA Guidelines on Split-Receipting," dated April 7, 2005.

from the Department's intention to curtail abusive tax shelter schemes involving charitable donations.[3] These changes generally apply to gifts made after December 20, 2002, with a few exceptions.

1. Intention to Give and "Eligible Amount" of Gift

At common law, in order to qualify as a gift, property must be transferred voluntarily with an intention to make a gift. Where the transferor has received any form of consideration or benefit, it is generally *presumed* that such an intention is not present. However, the Explanatory Notes to the July 2005 Amendments (the "Explanatory Notes") explain that the new subsection 248(30) provides the transferor with an opportunity to rebut this presumption. Specifically, subsection 248(30) provides that the existence of an advantage in respect of a property transferred to a qualified donee (e.g. a registered charity) does not "in and of itself" disqualify the transfer from being a gift under two situations, namely (a) where the amount of the advantage does not exceed 80% of the fair market value of the transferred property and (b) where the transferor establishes to the satisfaction of the Minister of National Revenue (the "Minister") that the transfer was made with the intention to make a gift. Under the latter scenario, the Explanatory Notes indicate that the taxpayer would need to apply to the Minister for a determination of whether the transfer was made with the intention to make a gift.

In order to take into account this new approach, subsection 248(31) provides that the "eligible amount" of a gift is the amount by which the fair market value of the property transferred exceeds the amount of the advantage in respect of the gift. Subsections 248(30) and (31) apply to gifts made after December 20, 2002.

The Explanatory Notes clarify that the tax benefit available to a taxpayer, by way of a charitable donation deduction or credit, is not considered an advantage or benefit that would reflect a lack of intent to make a gift. However, the Explanatory Notes also explain that this subsection is not intended "to allow a taxpayer to profit" from the making of a gift, such as in situations where the "primary intention" of the taxpayer for "entering into a transaction or series of transactions" is to "return a

[3] On December 5, 2003, at 6 p.m. (Eastern Standard Time), the December 2003 Amendments were announced to limit tax benefits from charitable donations made under tax shelter donation arrangements in order to curtail the scope of tax shelter donation arrangements after receiving public complaints and concerns with respect to donation promoters selling the "buy-low, donate-high" schemes that often provide the donor exceptionally high tax-benefits. The Department was concerned that the government was losing substantial amounts of tax dollars when the taxpayer/donor was able to claim higher tax deductions than he/she was otherwise entitled to.

profit to the taxpayer by way of a combination of tax and other benefits" so that the taxpayer is not "impoverished" by the transfer of the property to the charity.

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

- subsections 110.1(1) and 118.1(1) of the Act, concerning the types of gifts in respect of which an eligible amount will qualify for a deduction (for corporations) or a tax credit (for individuals);
- subsections 3501(1), (1.1), and (6) and subsections 2000(1) and (6) of the *Income Tax Regulations* requiring that official donation receipts reflect the eligible amount and the amount of advantage of a gift if it is made after December 20, 2002;
- subsection 149.1(1) of the Act concerning the definition of "disbursement quota;" and
- subsection 149.1(9) of the Act concerning the deemed income of the charity if it defaults under the rules concerning the accumulation of property pursuant to subsection 149.1(8).

Subsections 248(30) and (31) were first introduced by the December 2002 Amendments. They remained unchanged under the December 2003 Amendments, save and except the insertion of a clarification that the gifts in question are gifts made to "qualified donees" and that these provisions also apply to monetary contributions made to registered political parties and candidates. These provisions were brought forward and included in the February 2004 Amendments and the July 2005 Amendments without further changes.

2. Amount of Advantage

A broad definition of "advantage" is set out in subsection 248(32) of the Act. It was first introduced by the December 2002 Amendments and was substantially amended by both the December 2003 and February 2004 Amendments. This definition was again revised in the July 2005 Amendments.

The proposed definition of advantage includes two parts in paragraphs 248(32)(a) and (b) as follows: Paragraph 248(32)(a) of the Act provides that the amount of advantage in respect of a gift includes the value, at the time when the gift is made, of "any property, service, compensation, use or other benefit"[4] that the donor, or a person or partnership who does not deal at arm's length with the donor[5]

[4] The reference to "use" is introduced by the July 2005 Amendments.

has "received, obtained or enjoyed, or is entitled, either immediately or in the future and either absolutely or contingently, to receive, obtain or enjoy" that is (i) in consideration of, (ii) in gratitude of, or (iii) in "any other way related to" the gift.[6] Paragraph 248(32)(a) applies to gifts made after December 20, 2002, save and except that the provision concerning the phrase "in any other way related to" the gift in subparagraph 248(32)(a)(iii) applies to gifts made on or after 6 p.m. (Eastern Standard Time) on December 5, 2003. This broad definition of "advantage" in subsection 248(32)(a) has very serious implications, as evidenced by the following characteristics:

- Value of advantage - The value of an advantage is the total value of any "property, service, compensation, use or other benefit" in question.
- Timing of valuation - The value of an advantage is based on the time when the gift is made.
- Mode of the advantage - An advantage includes something that (1) is received, obtained, or enjoyed by someone or (2) someone is "entitled, either immediately or in the future and either absolutely or contingently" to receive, obtain or enjoy. The advantage could be (i) in consideration of, (ii) in gratitude of, or (iii) in any other way related to the gift. The Explanatory Notes indicate that an advantage may have been received "prior to the time of the gift or may be contingent or receivable in the future." This means that an advantage can be received prior to, at the same time as, or subsequent to the making of the gift by the donor. Furthermore, it does not appear necessary for a causal relationship to exist between the making of the gift and the receiving of the advantage if they are "in any other way" related to each other.
- To whom the advantage is provided - The Explanatory Notes indicate that an advantage may accrue either to the donor or to a person or partnership not dealing at arm's length with the donor.
- By whom the advantage is provided – The definition of advantage is silent regarding by whom the advantage may be provided. The Explanatory Notes provide that "it is not necessary that the advantage be received from the charity that received the gift." Presumably, it could include an advantage provided by a third party, even unbeknownst to the charity issuing the charitable donation receipt.

[5] The reference to "another person or partnership who does not deal at arm's length with and holds, directly or indirectly, an interest in the taxpayer" that was introduced by the February 2004 Amendments has not been included in the July 2005 Amendments.
[6] The reference to "in any other way related to" the gift in subparagraph 248(32)(a)(iii) was introduced by the December 2003 Amendments.

The Explanatory Notes indicate that subsection 248(32) is intended "to apply in respect of any transaction or series of transactions having either the purpose or the effect of reducing the economic impact to a donor of a gift or contribution." The Explanatory Notes indicate that the following are examples of an advantage:

> This includes, for instance, situations where a charity invests funds or acquires property in a manner that benefits the donor. . . . An example would include the option of a donor to satisfy or pay a loan by assigning or transferring to another person a property (including the rights under an insurance policy) that has less economic value than the amount of loan outstanding. Another example would include an assumption of a donor's risk by a charity, where the acquisition, directly or indirectly, of an interest in a property of the donor by the charity may have the effect of reducing the potential loss of the donor from that investment.[7]

In addition to paragraph 248(32)(a), the proposed paragraph 248(32)(b) of the Act provides that an advantage would also include the amount of limited-recourse debt incurred as determined pursuant to the newly proposed subsection 143.2(6.1) in respect of a gift at the time when the gift is made. The purpose of this proposed amendment is to curtail abusive tax shelter schemes involving limited-recourse debts.[8] This paragraph applies to gifts made on or after February 19, 2003.

3. Cost of Property Acquired by Donor

Subsection 248(33) of the Act provides that the cost of property acquired by the donor in the course

[7] These examples imply that the broad definition is, in part, intended to be one of a number of proposed amendments in the July 2005 Amendments to curtail abusive tax shelter schemes involving charitable donation of property. See Section B5 of this *Bulletin* in relation to subsection 248(35) of the Act for more details.

[8] See Section B4 of this *Bulletin* below in relation to "repayment of limited-recourse debt" regarding subsection 248(34) of the Act. The December 2003 Amendments proposed to curtail the use of arrangements involving limited-recourse debts by introducing a series of amendments to the Act, including the insertion of new subsection 143.2(6.1) to the Act, the amendment of the wording of subsection 143.2(13) before paragraph (a), the insertion of new paragraph (b) to subsection 248(32) introduced by the December 2002 Amendments, as well as the insertion of new subsection 248(34) to the Act. These changes had been included in the February 2004 Amendments and the July 2005 Amendments. Subsection 143.2(6.1) of the Act introduces a new definition of "limited-recourse debt." The cumulative effect of paragraph 248(32)(b) and subsection 143.2(6.1) is to reduce the amount of the gift made by the donor by the amount of the loan borrowed if the indebtedness is of limited recourse to the lender or if there is a "guarantee, security or similar indemnity or covenant" in respect to that debt or any other debts. Subsection 248(34) is proposed to be added to the Act to deem repayments of limited-recourse debts as gifts in the year they are repaid. Lastly, subsection 143.1(13) is amended so that it is applicable to gifts and monetary contributions by including references to "gift or monetary contribution" in this subsection. Please refer to *Charity Law Bulletin* Nos. 30 and 38 (mentioned in note **Error! Bookmark not defined.** above) for further details.

of making a gift is the fair market value of the property at the time when the gift is made. This value is relevant in computing the amount of advantage under subsection 248(32). For example, if a donor acquired a property from a charity as a result of the donor making a gift to the charity, then the cost of the property acquired by the donor (in computing the amount of the advantage) is the fair market value of the property.

Subsection 248(33) was first introduced by the December 2002 Amendments and was included in the December 2003 Amendments with the insertion of a clarification that this subsection also applies to monetary contributions made to registered political parties and candidates. The wording of subsection 248(33) was included in the February 2004 Amendments and again in the July 2005 Amendments without further changes. This subsection applies to gifts made after December 20, 2002.

4. Repayment of Limited-Recourse Debt[9]

Subsection 248(34) was introduced by the December 2003 Amendments as one of a number of amendments to the Act to curtail abusive tax shelter arrangements involving limited-recourse debts.[10] This subsection was included in the February 2004 Amendments (with minor wording changes) and the July 2005 Amendments. This subsection applies to gifts made on or after February 19, 2003.

This subsection generally provides that a repayment of the principal amount of a limited-recourse debt in respect of a gift is deemed to be a gift in the year it is paid. However, in some situations, the total amount of limited-recourse debt and other advantages to the donor may exceed the fair market value of the property transferred to the charity, thereby resulting in no eligible amount being available to the donor. In such cases, the donor would need to pay off the excess amount before any amount will be

[9] By way of background, other than the donation of property to charities under the gifting arrangements of tax shelter donation schemes, another type of gifting arrangement which the Department felt the need to restrict involves limited-recourse debts incurred by donors (also known as "leveraged loans" or "leveraged donation shelters"). This usually involves a donor borrowing monies from a lender, followed by the donor donating the borrowed funds together with some of his or her own funds to a charity in return for a charitable donation receipt for the cumulative amount donated. At the same time, the donor pays a fee or other charges to the promoter, which fee or charges would be used to purchase property or to be invested for a return that would, over the term of the loan, be sufficient to pay off the loan borrowed.
The February 2003 Budget, in expanding the definition of "tax shelter" in section 237.1(1) of the Act to include property acquired under a gifting arrangement, also expanded the definition of "tax shelter" to include a gifting arrangement under which it may reasonably be expected, having regard to representations made, that if a taxpayer makes a gift or contribution under the arrangement, a person (whether or not it is the taxpayer himself or herself) will incur an indebtedness in respect of which recourse is limited. The February 2003 Budget was introduced to Parliament as Bill C-28 and came into force on June 19, 2003 as *An Act to Implement Certain Provisions of the Budget Tabled in Parliament on February 18, 2003*, 2003, c.15.

[10] See note **Error! Bookmark not defined.** above.

allowed as a gift. The Explanatory Notes also explain that "a payment financed by other limited-recourse debt or made by way of assignment or transfer of a guarantee, security or similar indemnity or covenant is not recognized for these purposes." Examples in this regard include "the assumption of a taxpayer's limited-recourse debt by another person, in exchange for an insurance policy in favour of the taxpayer that guarantees a particular rate of return on an investment held by any person, would not qualify as a deemed gift under subsection 248(34)."

5. Deemed Fair Market Value and Non Arm's Transaction

Subsection 248(35) of the Act introduces a new deeming provision that generally applies to gifts made on or after 6 p.m. (Eastern Standard Time) on December 5, 2003. Subsection 248(35) was first introduced by the December 2003 Amendments and was brought forward in the February 2004 Amendments unchanged, and later included in the July 2005 Amendments with the introduction of a 10 year holding period in subparagraph 248(35)(b)(ii) which is explained further below.

The opening wording of subsection 248(35) provides that the fair market value of the property that is the subject of a gift, for purposes of determining the eligible amount of the gift under subsection 248(31), is *deemed* to be the lesser of (i) the "fair market value of the property otherwise determined" and (ii) the cost (or the adjusted cost base in the case of capital property) of the property to the donor immediately before the gift is made (the "Deeming Provision").

a) Application of the Deeming Provision

Paragraph 248(35)(a) indicates that the Deeming Provision applies if the property that is the subject of the gift was acquired by the donor as part of a gifting arrangement under subsection 237.1(1) of the Act. It is irrelevant *when* the property was acquired by the donor through the gifting arrangement. This proposed amendment is one of the changes to the Act brought by the Department to curtail abusive tax shelter donation schemes.

In addition, the Deeming Provision also applies to situations where the property is not acquired through a gifting arrangement. In this regard, paragraph 248(35)(b) indicates that the Deeming Provision applies to donations of property under two situations, namely, (1) if the property was acquired by the donor less than 3 years before the day on which the gift is made, pursuant to

subparagraph 248(35)(b)(i), and (2) if the donor acquired the property less than 10 years[11] before making the gift and it is "reasonable to conclude" that, at the time when the donor acquired the property, "one of the main reasons"[12] for the acquisition of the property was to make a gift to a qualified donee, pursuant to subparagraph 248(35)(b)(ii). Therefore, under scenario (1), if a donor acquired a property and donated the property within 3 years from the date of acquisition, then the fair market value of the property would be deemed to be the donor's cost (or adjusted cost base in the case of capital property) regardless of whether the donor had the intention to make a gift when the property was acquired. Under scenario (2), if the donor acquired the property within 10 years prior to making the gift, as long as it is *reasonable* to conclude that *one of the main reasons* why the donor acquired the property was to make a gift, then the Deeming Provision would apply. The burden is on the donor to prove that he or she did not have such an intention. Although it would appear that the purpose of subparagraph 248(35)(b)(ii) (i.e. scenario (2)) is intended to apply where the acquisition of the property by the donor was outside of 3 years but within 10 years, this has not been made clear in the proposed wording of the legislation.

Furthermore, the July 2005 Amendments also introduced a new subsection 248(36) to "look back" to situations where a donated property was previously acquired by a person or a partnership dealing non arm's length with the donor within the respective 3-year or 10-year period in relation to gifts made on or after July 18, 2005. In those situations, the cost (or adjusted cost base in the case of capital property) of the property[13] to the donor immediately before the gift is made would be deemed to be the lower of the donor's cost and the lowest cost to any such non arm's length person or partnership.[14]

The intention of subsection 248(36) is to prevent a donor from artificially increasing his or her cost by acquiring it from a non arm's length person at an inflated amount. It is intended to

[11] The 10 year holding period is introduced by the July 2005 Amendment. In the February 2004 Amendments, subparagraph 248(35)(b)(ii) applies to the entire life time of the donor.

[12] The February 2004 Amendments provided that the donor "expected to make a gift of the property" at the time when the property was acquired by the donor. However, the July 2005 Amendments now provides that it is not necessary that the *only* reason for the donor to acquire the property was to make a gift (as previously required by the February 2004 Amendments), but simply that *one of the main reasons* that the donor acquired the property was to make a gift. This has lowered the threshold required under subparagraph 248(35)(b)(ii) considerably.

[13] For purposes of determining the deemed fair market value under subsection 248(35).

[14] The meaning of "arm's length" and "related persons" are set out in subsections 251(1) and 251(2) of the Act, and explained in CRA's IT-419R2, dated June 8, 2004. See also CRA IT-64R4 dated August 14, 2001 entitled "Corporations" Association and Control."

include situations where a person not at arm's length has acquired the property within the relevant period, notwithstanding that another person at arm's length has also acquired the property in a chain of transactions within that period. Consider the example where A acquires a property from a person at arm's length, then sells the property to B who sells the property to C, and C donates the property to a charity, all within a 3-year period. Assuming A and C are in a non arm's length relationship, while B is arm's length with A and C, then the cost to C would be deemed to be the lower of A's cost and C's cost. If this chain of transactions occurred within a 10 year period, the same result would be reached provided that one of the main reasons for C (rather than A) acquiring the property was to make a gift. However, if the property was *acquired* by A outside of the 10-year period, then subsection 248(36) would not apply. However, it is not clear when the non arm's length test would apply, e.g. at the time when the donation was made, at the time when the donor acquired the property, or at the time when another non arm's length person acquired the property within the respective hold periods.

b) Non-Application of the Deeming Provision

The Deeming Provision in subsection 248(35) does not apply to inventory, real property or an immovable[15] situated in Canada, certified cultural property, publicly traded shares or ecological gifts, set out in paragraphs 248(37)(a), (b), (c) and (d). Two new exceptions are inserted by the July 2005 Amendments introducing new paragraphs 248(37)(e) and (f). These exceptions have the effect of exempting the application of the Deeming Provision to circumstances involving a shareholder transferring property to a controlled corporation in exchange for shares issued by the corporation, and then donating the shares to a charity, or having the corporation donate the shares to a charity. Furthermore, if subsections 85(1) or 85(2) of the Act applied to the transfer of such an exempt property to the corporation, then subsection 248(37) would preclude the application of subsection 248(35) to that property if it were then donated by the corporation.

In addition, paragraph 248(35)(b) does not apply where the gift is made as a consequence of the death of the donor.[16]

[15] The reference to "immovable" is introduced by the July 2005 Amendments.
[16] See the opening wording of paragraph 248(35)(b). See also subsection 248(10) of the Act for the meaning of "series of transactions."

6. Anti-Avoidance

Subsection 248(38) was first introduced by the December 2003 Amendments to prevent a donor from avoiding the application of the Deeming Provision set out in subsection 248(35) by disposing of and reacquiring a property before donating it to a qualified donee. This subsection was included, unchanged, in the February 2004 Amendments. The wording of subsection 248(38) was amended by the July 2005 Amendments.

Pursuant to this subsection, for gifts made on or after July 18, 2005, the eligible amount of a gift is deemed to be nil if a transaction or a series of transactions either (i) has, as one of its purposes, the avoidance from the application of subsection 248(35), or (ii) would otherwise result in a tax benefit to which the general anti-avoidance rule in subsection 245(2) would otherwise apply.[17]

However, for gifts made on or after 6 p.m. (Eastern Standard Time) on December 5, 2003 but before July 18, 2005, the original wording introduced by the December 2003 Amendments would apply. In this regard, if "it can reasonably be concluded that one of the reasons for a series of transactions" that includes a disposition or acquisition of property of a donor is to increase the amount that would be deemed to be the fair market value of the gift under subsection 248(35), then the cost of the property shall be deemed to be the lowest cost to the donor to acquire the property in question or "an identical property at any time."

7. Substantive Gifts

The February 2004 Amendments introduced a new subsection 248(38) that applies to gifts of capital property and eligible capital property made on or after February 27, 2004. Subsection 248(39) is included in the July 2005 Amendments with some wording changes.

Subsection 248(39) is intended to prevent a donor from avoiding the application of the Deeming Provision set out in subsection 248(35) by disposing of property to a qualified donee and then donating the proceeds of disposition (rather than donating the property itself) to either that qualified donee or to another qualified donee that does not deal at arm's length with the qualified donee that

[17] The reference in paragraph 248(35)(b) to the general anti-avoidance rule in subsection 245(2) is introduced by the July 2005 Amendments.

purchased the property from the donor. The property disposed of by the donor is referred to as a "substantive gift" in this subsection. Under these situations, the Deeming Provision set out in subsection 248(35) would apply and the fair market value of the substantive gift (i.e the proceeds of sale) would be "deemed" under subsection 248(39) to be the lesser of the fair market value of the substantive gift and the cost (or the adjusted cost base in the case of capital property) of the substantive gift to the taxpayer immediately before its disposition to the qualified donee. This subsection does not apply if subsection 248(35) would not have applied to a gift by the taxpayer of that property.

8. Reasonable Inquiry and Information from Donor

The July 2005 Amendments introduced new subsections 248(40) and (41) that imposed an onus on charities to make inquiries of donors concerning gifts made on or after January 1, 2006. Pursuant to subsection 248(40), a charity issuing a donation tax receipt with a stated eligible amount in excess of $5,000 would be required to make a "reasonable inquiry" as to the existence of any circumstances in respect of subsection 248(31), (35), (36), (38) and (39) that would cause the eligible amount to be less than the fair market value of the property (determined without regard to subsection 248(35)). Although subsection 248(40) does not make any reference to making inquires into circumstances involving subsections 248(32), (33) and (34),[18] such inquiry is necessary when the charity inquires into circumstances involving the "eligible amount" under subsection 248(31). This is confirmed by the Explanatory Notes, which listed the following examples of the types of inquiries required:

- the existence of an amount of advantage in respect of the gift, including any limited-recourse debt under subsection 143(6.1) of the Act;
- whether a gifted property was acquired in the context of a tax shelter;
- whether a gifted property was acquired by the donor or any person dealing at non arm's length with the donor within the last 3 years and, if so, what the lowest cost to the donor or any person dealing at non arm's length was; and
- whether a gifted property was acquired by the donor or any person dealing at non arm's length with the donor within the last 10 years (but not including the 3 years referred to above), whether

[18] These subsections are in relation to circumstances involving the amount of advantage, the cost of the property, and repayment of limited-recourse debt.

it is reasonable to conclude that one of the main reasons for acquiring the property was to make a gift and, if so, what the lowest cost to the donor or any person dealing at non arm's length was.

Subsection 248(41) also provides that the charity would not be required to inquire whether the donor will be electing under subsection 110.1(3) or 118.1(6) to reduce the amount reported as the fair market value of the gift.[19]

Subsection 248(40) imposes a heavy onus on the charity to make the necessary inquiries of the donor. It would appear that if a charity issued a receipt without making the necessary inquiries, the receipt issued by the charity would not reflect the correct eligible amount of the gift and the charity could be subject to a penalty under section 188.1 of the Act in respect of taxation years that begin after March 22, 2004. [20] However, it is not clear whether the penalties and sanctions under subsections 188.1(7) and 188.1(8) for issuing receipts with incomplete or incorrect information or under subsection 188.1(9) and 188.2(1) for issuing receipts with false information would apply. Under subsections 188.1(7) and 188.1(8), there would be a 5% penalty on the eligible amount stated on the receipt the first time a charity issues a receipt with incomplete or incorrect information and a 10% penalty on repeat infractions in five years. Under subsection 188.1(9), a 125% tax on the eligible amount stated on the receipt will be imposed, together with the suspension of tax-receipting privileges under subsection 188.1(1) if the total of all penalties under subsection 188.1(9) exceeds $25,000 in a taxation year. In addition, the Minister has the discretion to revoke the charitable registration of the charity, notwithstanding the ability of the Minister to impose the said penalties and sanctions.[21]

Subsection 248(41) provides that if, before a donation tax receipt is issued by the charity, the donor failed to provide the above mentioned information to the charity, then the eligible amount of the gift would be deemed to be nil. Since the charity is required under subsection 248(40) to make inquiries of donors for such information, subsection 248(41) would apply whether or not the charity has made the required inquiries. In other words, if the charity has not made the required inquiries in issuing the donation receipt, the eligible amount would be deemed to be nil and the charity may be subject to the

[19] Subsections 110.1(3) and 118.1(6) have also been changed by the July 2005 Amendments. These subsections allow a donor of capital property to a charity to designate a value to be treated as the proceeds of disposition for the purposes of calculating the donor's capital gain and the fair market value of the gift for purposes of calculating the donor's deduction (for corporations) or tax credit (for individuals).
[20] These penalties and sanctions were introduced by Bill C-33 which was enacted as *A Second Act to Implement Certain Provisions of the Budget Tabled in Parliament on March 23, 2004* that came into force on May 13, 2005.
[21] Subsection 168(1) of the Act.

penalties and sanctions mentioned above. However, if the charity has made the necessary inquiries but was not advised by the donor of the relevant information, then the eligible amount would still be deemed to be nil but the charity should not be subject to any penalties or sanctions. Under that circumstance, there should not be any penalty on the charity because it has satisfied the onus imposed on it.

That said, it is unclear what type of inquiry would be recognized to be "reasonable." Although it would appear that the level of reasonableness would depend on the circumstances, it would also appear that the best approach to be taken by charities is to develop and implement a gift receipting policy conforming to the highest possible standard, such as a questionnaire for donors to complete and possibly requiring donors to provide sworn statements in this regard. Further, issuing donation receipts for each gift received where possible, rather than issuing one receipt at the end of the year for all gifts received, would reduce the impact of the application of this provision.

C. CONCLUSION

The July 2005 Amendments, once enacted, will bring sweeping changes that affect charities in many ways. It is important that charities and their advisors become familiar with these proposed changes in order to ensure compliance. These new rules summarised in this Bulletin include, for example, the following:

- how to determine the "eligible amount" of gifts on donation tax receipts;
- the complicated rules concerning split-receipting;
- the broad definition of "advantage" and the rules regarding what would constitute an "advantage;"
- how to determine the "cost" of property a donor received from a charity in return for a gift;
- the meaning and application of limited-recourse debts;
- the meaning of the Deeming Provision, how it works, and how the three-year and the ten-year hold periods apply, including in situations where a non arm's length person has acquired the property in the three-year and ten-year periods;
- the types of property and transactions that are exempt from the Deeming Provision;
- the meaning and application of the special anti-avoidance rule in subsection 248(38) and the general anti-avoidance rules in the Act;
- when a substantive gift would arise, how a charity would recognize a "substantive gift" and how it affects the acceptance and receipting of such a gift;

- what "arm's length" means and how it applies in conjunction with the Deeming Provision, the valuation of an advantage and the application of a substantive gift;
- when and what to inquire of donors concerning gifts of property, such as when the donated property was acquired, the cost of acquisition, whether there is any advantage related to the gift, the value of the advantage, whether the donor has any obligation in relation to any limited-recourse debt in making the gift, whether the donated property was acquired through a tax shelter gifting arrangement, whether any non arm's length person has acquired the donated property within the three or ten years prior to making the gift, etc.

It is also important that charities exercise due diligence in satisfying the heavy onus imposed on them to make inquiries of donors, failing which they may run the risk of penalties and sanctions being imposed or possibly their charitable status being revoked. In this regard, charities may need to develop and implement gift receipting policies and questionnaires for donors to complete and possibly even require donors to provide sworn statements in this regard. Charities may also find it necessary to change their gift receipting practices by issuing donation receipts for each gift received, rather than issuing one receipt at the end of the year for all gifts received, so that the number of receipts over $5,000 would be reduced ,thereby reducing the impact of subsection 248(40) in necessitating inquiries of donors.

Since the effective date for each of the new rules set out in subsections 248(30) to (41) is different, it is important for charities to be aware of them in order to comply appropriately. The effective dates are summarized below as follows:

- subsection 248(30) (concerning intention to give), 248(31) (concerning the eligible amount of a gift), and subsection 248(33) (concerning the cost of property acquired by the donor) apply to gifts made after December 20, 2002;
- subsection 248(32) (concerning amount of advantage) applies to gifts made after December 20, 2002, except that subparagraph 248(32)(a)(iii) (concerning an advantage that is in any other way related to the gift) applies to gifts made on or after 6 p.m. Eastern Standard Time on December 5, 2003, and that subsection 248(35)(b) (concerning limited-recourse debt) applies to gifts made on or after February 19, 2003;
- subsection 248(34) (concerning repayment of limited-recourse debt) applies to gifts made on or after February 19, 2003;

- subsection 248(35) (concerning the Deeming Provision) applies to gifts made on or after 6 p.m. Eastern Standard Time on December 5, 2003;
- subsection 248(36) (concerning non arm's length transactions for purposes of subsection 248(35)) applies to gifts made on or after July 18, 2005;
- subsection 248(37) (concerning exceptions to the Deeming Provision) applies to gifts made on or after 6 p.m. Eastern Standard Time on December 5, 2003;
- subsection 248(38) (concerning anti-avoidance) applies to gifts made on or after July 18, 2005, and that the previous wording of subsection 248(38) proposed in the December 2003 Amendments applies to gifts made on or after 6 p.m. Eastern Standard Time on December 5, 2003, but before July 18, 2005;
- subsection 248(39) (concerning substantive gifts) applies to gifts made on or after February 27, 2004; and
- subsections 248(40) and (41) (concerning reasonable inquiry) apply to gifts made on after January 1, 2006.

There are many areas where the July 2005 Amendments are not clear. It is hoped that these grey areas will be clarified either by remedial amendments to the Act or by CRA providing the charitable sector with administrative guidelines on how these statutory provisions will be interpreted by CRA and how charities may be required to comply with them.

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