CARTERS.ca™

CHARITY LAW BULLETIN NO. 187

Carters Professional Corporation / Société professionnelle Carters
Barristers, Solicitors & Trade-mark Agents / Avocats et agents de marques de commerce

JANUARY 28, 2010
Editor: Terrance S. Carter

A PROPOSED ALTERNATIVE TO SPLIT-RECEIPTING

By Professor Adam Parachin[*]

A. INTRODUCTION

A charity can issue an official donation receipt only when a donor makes a "gift." Perhaps surprisingly, the *Income Tax Act* does not define what transactions qualify as gifts. This has resulted in considerable uncertainty for both charities and donors. In December of 2002, the Department of Finance released draft rules – the so-called "split-receipting rules" – that were intended to clarify matters. These rules, though they have yet to be enacted and currently are not even before Parliament in bill format, are being enforced by the Canada Revenue Agency. In this article, I suggest that the split-receipting rules should be abandoned and advocate in favour of an alternative reform. Readers interested in a more detailed analysis of these matters may consult A. Parachin, "Reforming the Meaning of 'Charitable Gift': The Case for an Alternative to Split Receipting," *Canadian Tax Journal* (2009) Vol. 57, No. 4, 787.

B. THE NEED FOR REFORM:

It is no secret that ambiguity over the precise meaning of charitable "gift" has frustrated gift planning. The problem has been especially acute in relation to the following issues.

1. Significance of Consideration

Innumerable authorities have held that a charitable gift for income tax purposes means a gift at common law, i.e., a transfer of property for *no consideration*. This means that a donor who sells

[*] Faculty of Law, University of Western Ontario, aparachi@uwo.ca.

property to a charity for a deeply discounted price or acquires property from a charity for in excess of fair market value consideration is not entitled to a gift receipt. The idea that gift means a transfer for no consideration is pervasive in the cases. Many of the gift criteria enforced by courts that seemingly have nothing to do with the issue of consideration – e.g., the requirements for voluntariness, charitable motive and donor intent – have essentially been used by courts as tools for disqualifying transfers for consideration as gifts.

Nevertheless, there are cases in which courts have held that gifts were made even though consideration was present. Frustratingly, these authorities do not explain why they were departing from the no consideration rule. In fact, they rarely even acknowledge that they are departing from precedent. Thus, the state of the law is such that, while it is generally understood that only transfers for no consideration can qualify as charitable gifts, there are a sufficient number of sporadic exceptions that it has never really been clear either why or when the presence of consideration will disqualify a transaction as a charitable gift.

2. <u>Donor Restrictions</u>

The topic of donor restricted donations raises many difficult issues of law. One such issue is the legal nature of such donations. There seems to be a widespread misperception in the gift industry that a donor restricted donation may be made without creating a trust. For a variety of reasons, I contend that this is wrong. The better view is that most so-called conditional gifts are actually not gifts at common law but rather purpose trusts. The problem that this creates is that a gift receipt is available to a donor only if a "gift" is made. We therefore need to know whether the meaning of gift under the *Income Tax Act* is broad enough to include donations structured in the legal form of charitable purpose trusts or whether it is restricted to common law [read unconditional] gifts. The tax authorities have never squarely addressed the matter, leaving considerable uncertainty over this foundational aspect of gift planning.

3. <u>Charities as Beneficiaries of Trusts</u>

Donors sometimes create trusts under which charities are giving beneficial interests in trust income and/or capital. The law dealing with such donation arrangements is surprisingly underdeveloped. It is not always clear when the settlor of such a trust will be considered to have made a gift for income tax

purposes. Further, there is much confusion over the tax treatment of trusts that distribute trust income or capital to charitable beneficiaries. Has the trust made a charitable gift or merely distributed trust property to a beneficiary of the trust? The confusion stems at least in part from the association of gift with its common law meaning. If "gift" is understood as meaning a common law gift, then it is easy to see how the law dealing with other donation arrangements has been left to languish.

C. THE PROPOSED SOLUTION – THE SPLIT RECEIPTING RULES:

The draft split-receipting rules provide that the receipt of partial consideration by a donor will not preclude a transaction from qualifying as a gift. Thus, under the proposed rules, a donor who transfers property worth $100,000 to a charity for consideration worth $10,000 may be considered to have made a gift of $90,000. At first glance, this would seem to be fairly responsive to the problems identified above.

To be sure, the proposed new rules seem to remove ambiguity over whether consideration automatically vitiates a transaction as a gift. Also, inasmuch as the rules make clear that a donation need not be in the legal form of a common law gift, they seem to make clear that gift planners can structure donations in legal forms other than gifts, e.g., contractual transfers, purpose trusts or whatever other legal form makes sense in the circumstances.

There are, however, a number of reasons to conclude that the proposed split-receipting rules are unlikely to achieve much in the way of meaningful reform:

- The split-receipting rules leave the term gift undefined. The absence of a statutory definition is ultimately what caused problems in the first place. Leaving the term undefined is to repeat a past mistake.

- It is apparent from Canada Revenue Agency publications that, even under the proposed split-receipting rules, gift continues to be closely associated with its common law meaning. In other words, the split-receipting rules are being approached by the Canada Revenue Agency as though they merely establish a limited exception to the general rule that gift means a common law gift. The legal form of a donation thus continues to be a potentially important factor. This form over substance approach is misguided. It will continue to frustrate the development of much needed tax policy in relation to donations structured in the legal form of trusts.

- Gift criteria that have historically been employed to disqualify as gifts transfers for consideration – e.g., voluntariness, charitable motive and donor intent – continue to be enforced under the split-receipting rules. What is the continued relevance of these criteria if split-receipting is meant to allow transfers for partial consideration to qualify as gifts? Confusion over the meaning of gift can be anticipated to continue because of the continued enforcement of gift criteria that one might reasonably have thought would now be irrelevant.

D. AN ALTERNATIVE SOLUTION – STATUTORY DEFINITION OF "*CHARITABLE DONATION*"

A few points stand out to me from the gift jurisprudence and reform efforts to date. One is the necessity for a statutory definition. Leaving the term gift undefined has not and will not work to move away from the common law understanding of the term. I propose the enactment of a statutory definition of "*charitable donation.*" This expression lacks any established meaning at common law that could frustrate efforts to move beyond the form-over-substance approach of the common law that has prevailed in the authorities.

But how should this term be defined? This brings me to the second point, the importance of theory. The theoretical thinking behind the tax concessions for charitable gifts does more than merely explain why these concessions exist; it also informs the analysis of what transactions should qualify for the tax concessions.

Subsidy theory is the most commonly accepted theory accounting for the tax concessions for charitable gifts. Subsidy theory posits that tax concessions for charitable gifts are no more than a state financial subsidy for charities delivered through income tax law. The subsidy is said to be defensible because (1) charities do good works and (2) charities would be underfunded without a state subsidy.

But if this is really all there is to it, then many of the issues that the authorities have fixated upon, e.g., whether the donor received consideration, had the requisite donor intent, donated voluntarily or was inspired by a charitable motive, are utterly irrelevant. All that really matters is whether the donor has economically equipped the charity to carry out its charitable purposes. If so, then the transaction can qualify as a gift regardless of whether the donation is structured as a common law gift, a trust, a contractual transfer or any other kind of transaction.

Based on these observations, I propose a statutory definition of *charitable donation* that allows any transfer of property, regardless of how it is structured, to qualify for the tax concessions for charitable gifts. This will remedy much of the incoherence and confusion that plagues the current jurisprudence.

Admittedly, my proposed definition will not solve all of the problems with the current tax treatment of charitable gifts. The confused treatment of distributions from trusts to charitable beneficiaries would remain unresolved. Similarly, some of the problems associated with donations structured as charitable purpose trusts would continue. For example, while my proposed statutory definition makes clear that a donation is made when a taxpayer transfers property to a charity to hold as a trustee of a charitable purpose trust, it leaves unresolved whether this donation arrangement creates a new taxpayer – the purpose trust – separate from the donor and the charitable donee.

Nevertheless, by reorienting thinking away from the view that gift means a common law gift and toward the more theoretically sound view that a charitable donation is any transaction that has a particular economic effect—the enrichment of a charitable donee—my reform removes the blinders that are responsible for the poorly developed state of the law in relation to donation arrangements involving trusts. The statutory definition that I have proposed thus paves the way for future reform in relation to these donation arrangements.

DISCLAIMER: This is a summary of current legal issues provided as an information service by Carters Professional Corporation. 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 a 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.

© 2010 Carters Professional Corporation

Document2