CARTERS
BARRISTERS
SOLICITORS
TRADEMARK AGENTS

CHURCH LAW BULLETIN NO. 38

SEPTEMBER 29, 2011

EDITOR: TERRANCE S. CARTER

MORE TECHNICAL INTERPRETATIONS ON THE CLERGY RESIDENCE DEDUCTION

By Terrance S. Carter and Jennifer M. Leddy *

A. INTRODUCTION

Over the past several months the Canada Revenue Agency ("CRA") Income Tax Rulings Directorate ("the Directorate") has released a series of technical interpretations on the clergy residence deduction ("CR Deduction"), which is provided for in paragraph 8(1)(c) of the *Income Tax Act*[1] ("ITA") and interpreted in Interpretation Bulletin IT-141R, Clergy Residence Deduction[2] ("IT-141R"). The four technical interpretations that are the subject matter of this *Charity Law Bulletin* provide clarity on the manner in which CRA interprets the terminology used in paragraph 8(1)(c), and thus provides guidance to organizations and individual taxpayers on CR Deduction eligibility. In particular, these technical interpretations highlight the importance of careful assessment of whether an organization's operations and job descriptions meet the eligibility requirements. There is also emphasis on a complete and careful presentation of the facts to the Directorate.

It should be noted that technical interpretations provided to the public by the Directorate are neither income tax rulings, nor are they binding on CRA.[3] As well, interpretation bulletins, such as IT-141R, are issued to provide technical interpretations and CRA's positions regarding certain income tax law provisions. They do

* Terrance S. Carter, B.A., LL.B., Trade-Mark Agent, is the managing partner of Carters Profession Corporation, and counsel to Fasken Martineau DuMoulin LLP on charitable matters. Jennifer M. Leddy, B.A. LL.B., practices charity and not-for-profit law with the Ottawa office of Carters Professional Corporation. The authors would like to thank Christine Kellowan, B.A. (Hons), J.D., Student-at-Law, for assisting in the preparation of this bulletin

[1] R.S.C. 1985, c. 1 (5th Supp.).

[2] Canada Revenue Agency, Interpretation bulletin IT-141R, "Clergy Residence Deduction [Consolidated]" (6 December 2001).

[3] Canada Revenue Agency, *Written Interpretations*, online: Canada Revenue Agency <http://www.cra-arc.gc.ca/tx/txprfssnls/srvcs/ntrprttns/wrttn-eng.html>.

not have the force of law.[4] While the courts may give deference to interpretation bulletins, they are not bound by them. Organizations should bear these considerations in mind when reviewing these materials and engaging in tax planning.

B. OVERVIEW OF PARAGRAPH 8(1)(C) OF THE *INCOME TAX ACT*

In order to understand the Directorate's technical interpretations, it is necessary to provide some background information on the legislative framework governing the CR Deduction. Pursuant to paragraph 8(1)(c) of the ITA, a taxpayer may claim an income tax deduction when calculating the income from his or her employment or office, in respect of his or her residence, if he or she is a member of the clergy or of a religious order, or a regular minister of a religious denomination. This provision has been interpreted to require that two tests be satisfied in order for a taxpayer to be eligible for the CR Deduction.

First, the status test requires a taxpayer to be one of the following: (i) a member of the clergy; (ii) a member of a religious order; or (iii) a regular minister of a religious denomination. Second, the function test requires that a taxpayer perform one of the following functions: be in charge of or ministering to a diocese, parish or congregation, or be engaged exclusively in full-time administrative service by appointment of a religious order or religious denomination. The technical interpretations address the definitions of "religious order" and "regular minister" in relation to the status test, and the definition of "ministering to a congregation" in relation to the function test.

Organizations and individual taxpayers must be wary of the technical nature of these tests. They should inform themselves of the practical application of the tests and the meaning of relevant terminology as is discussed in IT-141R. For more information on the tests and discussion on other technical interpretations on paragraph 8(1)(c) see "Technical Interpretations Re: Clergy Residence Deductions" in *Church Law Bulletin No. 3*, available online at http://www.carters.ca/pub/bulletin/church/2010/chchlb30.pdf. [5]

[4] Canada Revenue Agency, Current income tax interpretation bulletins (ITs), online: Canada Revenue Agency <http://www.cra-arc.gc.ca/tx/tchncl/ncmtx/ntcs-eng.html#1>.
[5] Jennifer M. Leddy, "Technical Interpretations Re: Clergy Residence Deductions" *Church Law Bulletin No. 3* (24 June, 2010), online: Carters Professional Corporation <http://www.carters.ca/pub/bulletin/church/2010/chchlb30.pdf>.

C. SUMMARY AND ANALYSIS OF TECHNICAL INTERPRETATIONS

1. Organization Providing Faith-based Community Services is not a Religious Order

In the first technical interpretation[6], dated February 1, 2011, the issue was whether a rabbi, who was an employee of a particular entity (the "Entity"), was considered to be exclusively in full-time administrative service by the appointment of a religious order pursuant to the function test. The Directorate ultimately ruled that the function test was not satisfied because the Entity was not a "religious order" within the meaning of paragraph 8(1)(c).

As mentioned above, one of the eligible functions under the function test is being engaged exclusively in full-time administration service by appointment by a religious order. To determine whether the Entity qualified as a "religious order" the Directorate quoted the relevant definition in paragraph 8 of IT-141R:

> The term "religious order" means a group of people bound by the same religious, moral and social regulations and discipline. A religious order may comprise all the members of an organization or only an identifiable group within that organization…Not every religious organization is a religious order. Whether or not an organization or a group of individuals within an organization is a religious order is a question of fact to be determined on a case-by-case basis. No factor predominates and each must be assigned its proper weight in the context of all the facts.

This definition is supplemented by six criteria established by Bowman J. in *McGorman et. al. v. The Queen*[7], which are indicative of whether the definition of "religious order" is met. The six criteria are as follows:

a) The purpose of the organization should be primarily religious.
b) The members must agree to adhere to, and in fact adhere to, a strict moral and spiritual regime of self-sacrifice and dedication to the goals of the organization to the detriment of their own material well being.
c) The commitment of the members should be full-time and of a long-term nature. In some cases it may be for life, but this is not essential. It is important that it not be short term, temporary or part-time.
d) The spiritual and moral discipline and regime under which the members live must be markedly stricter than that to which the lay church members are expected to adhere.

[6] Canada Revenue Agency, Document no 2010-383881E5, "Clergy residence deduction" (01 February 2011).
[7] (1999), 99 D.T.C. 699, [1999], 3 C.T.C. 2630, [*McGorman* cited to D.T.C.].

e) Admission to the order must be in accordance with strict standards of spiritual and personal suitability.
f) There should generally be a sense of communality.[8]

Bowman J. expanded upon the first criterion by explaining that it is permissible for an organization to have "other objects within the overall context of the primarily religious purpose such as education, the relief of poverty, or the alleviation of social ills and suffering."[9] As well, permissible objects are not confined to only "preaching the gospel and prayer and mediation",[10] but may extend to "works beneficial to humanity such as running hospitals or helping the poor and homeless."[11] The Directorate referred to these passages in its consideration of whether the first criterion was satisfied by the taxpayer.

After wholly redacting the portion of the technical interpretation that describes the purpose of the Entity, the Directorate ruled that the Entity had not satisfied the first criterion because its primary purpose was the provision of community services. By providing services that focused on the "uplifting the Jewish community and …help[ing] them in times of need", the Directorate was of the view that the Entity was a "faith-based non-profit social service community" whose primary purpose was community services. It is not clear how the Directorate distinguishes between a religious organization that undertakes "works beneficial to humanity such as running hospitals or helping the poor and homeless" from a "faith-based non-profit social service community".

The omission of the relevant facts regarding the Entity's purpose makes it difficult to make analogies regarding which organizations are likely to qualify as a "religious order", though the reference to relevant case law by the Directorate does provide some guidance as why the Entity did not satisfy the first criterion.

According to the first case cited, *Zylstra Estate v. The Queen*,[12] the Federal Court held that two organizations were not religious orders because, first, there was no expression of faith or of religious purpose apart from the education purpose of each organization that distinguished each organization

[8] *Ibid*., para. 46.
[9] *Ibid*.
[10] *Ibid*.
[11] *Ibid*.
[12] [1994], F.C.J. No. 1648, [1995]1 C.T.C. 287 (F.C.T.D.) [*Zylstra Estate* cited to F.C.J.].

and its members from the churches or denominations they served.[13] Without such an expression of faith or of religious purpose, it would be difficult to distinguish the religious order from other institutions serving the general religious purposes of the churches concerned.[14] Second, the organizations' primary purpose was education that was offered with a religious emphasis.

The second case cited, *Osmond v. The Queen*[15], the Tax Court of Canada held that a group of officials who operated a college did not constitute a religious order.[16] The Directorate quoted the following statement from the Tax Court's reasoning: "in order to form a religious order, persons must submit to particular rules uniting them, rules that are normally more compelling, usually vows, than those generally uniting the adherents to a religion or particular denomination."[17]

Based on this case law, the Directorate concluded that it was not presented with any information that "indicate[d] that the Entity [was] bound by a statement of faith or that any particular vow is unique to that organization which sets apart its members from the layman." Having ruled that the first criterion was not met, the Directorate did not discuss whether the other five criteria were satisfied. It did state, however, that in order to be a religious order, all six criteria must be met.

Interestingly, a comparison of the six criteria enumerated in the McGorman case and the application of the case law cited by the Directorate to interpret the first criterion indicates considerable overlap. In its interpretation of the first criterion, the Directorate appears to have relied upon the some of the other criteria to determine whether an organization is primarily religious. For example, the requirements in the Osmond case that members of a particular religious order submit to rules that are more compelling then those uniting general adherents and to be bound by a statement of faith or vow that sets the members apart from laypeople are somewhat similar to the fourth criterion regarding stricter standards for members.

[13] *Ibid*., para. 31.
[14] *Ibid*., para. 32.
[15] [1998], T.C.J. No. 1086, [1999] 1 C.T.C. 2550 (T.C.C.) [*Osmond* cited to T.C.J.].
[16] *Ibid*., para. 14.
[17] *Ibid*.

This decision is consistent with other technical interpretations[18] that have found that a "faith based non-profit social service organization", as that is understood by CRA, does not have a purpose that is primarily religious. While it might be considered by some that this approach may signal a narrowing of the test for religious order, without the benefit of all the facts, particularly the key fact concerning the purpose of the entity, it is difficult to conclude whether such is the case. The decision suggests the need for organizations to ensure that the charitable objects in their letters patent clearly describe the religious purpose of the organization. As well, it may be prudent to include a definition of "religious order worker" or similar terminology in the general operating by-law of the organization.

2. Spiritual Care Coordinator Eligible for the CR Deduction

In the second technical interpretation[19], dated March 10, 2011, the issue was whether an ordained minister who worked as a spiritual care coordinator in a medical service centre was eligible for the CR Deduction. The Directorate ruled that the taxpayer was eligible. In relation to the status test, the Directorate found that the taxpayer was a "member of the clergy" because he or she was an ordained minister that was set apart from the other members of the church or religious denomination as a spiritual leader.

In relation to the function test, the taxpayer claimed to be "in charge of, or ministering to, a diocese, parish or congregation". According to the decision, the employer was an "medical service centre which offer[ed] a wide variety of services, including, the Spiritual Care Services, and that, as a "Spiritual Care Practitioner", ...[the taxpayer] provide[d] spiritual care for admitted inpatients, residents, clients and their families, and facility staff regardless of their religious affiliations." The Directorate ruled that the employer had not satisfied the definitions of "parish" or "diocese" found in Black's Law Dictionary, as it was not "a division of a town or district, subject to the ministry of one pastor" or "a territorial unit of the church, governed by a bishop, and further divided into parishes", respectively. The Directorate also had to determine whether the taxpayer was "ministering to a congregation". Quoting IT-141R, the Directorate stated that,

> "Ministering" is a very broad concept of serving or attending to the needs of a congregation, diocese or parish, or its individual members. This [activity]

[18] *Supra* note 5 at 3.
[19] Canada Revenue Agency, Document no 2010-0387251E5, "Clergy residence" (01 March 2011).

> should be looked at within the context of the religious organization's practices and expectations. If a person who meets the status test is employed within a congregation, he or she is considered to be ministering to a congregation if he or she is fulfilling a pastoral or ministerial role in the manner requested by that congregation.

In conjunction with this definition, the Directorate also referred the McGorman case which defined "ministering" as meaning "to serve" or "to attend the spiritual needs of"[20]. It quoted the following statement of Bowman J. in the McGorman case:

> A clergyman, minister, priest or spiritual counsellor ministers to the spiritual needs of a congregation, collectively or individually. Ministers are, however, called on to do much more than offer spiritual guidance. They provide psychological and marital counselling. They advise on family and career related matters. It is to the church that people turn when faced with the infinite variety of problems that arise in life. Ministering is a very broad concept, particularly in the context of the work of a person of the cloth.[21]

When applied to the taxpayer's job description the Directorate ruled that the above stated definition of "ministering" was satisfied. Among other things, the job description included the following activities in relation to spiritual care services for residents: organizing services, implementing programs, providing information on services, and participating in the development of clinical decision support guidelines for staff and other organizational documents.

Although the taxpayer was not ministering in the traditional setting of a church, the definition of "congregation" was met. Quoting paragraph 15 of IT-141R, the CRA stated that, "[c]ongregations can be of a diverse and fluid makeup and require neither voluntary attendance nor homogeneity of religious belief. Chaplains in hospitals, jails, the armed forces and other such organizations are generally considered to minister to congregations." Therefore, patients, families, and friends and staff that used the centre constituted a congregation within the meaning of paragraph 8(1)(c).

[20] *Supra* 7 at para. 56.
[21] *Ibid*.

3. University Campus Minister Eligible for the CR Deduction

In the third technical interpretation[22], dated April 5, 2011, the issue was whether a university campus minister with the Navigators of Canada ("Navigators") was eligible for the CR Deduction. The Directorate responded in the affirmative. In applying the status test, the Directorate found, that notwithstanding the decision in *Koop et. al. v. The Queen*[23], which found that the Navigators was not a religious order, subsequent modifications to the Navigators' organizational policies and procedures meant that the organization qualified as a religious order. Those modifications were not disclosed in the decision.

In relation to the function test, the taxpayer claimed to be "ministering to a congregation". Using the above stated definition of "ministering", the Directorate assessed the facts at hand to find that that the taxpayer was in fact "ministering". While the decision redacted a portion of the taxpayer's duties, the following specific duties were included: preach and teach on spiritual and theological subjects; research and study religion, reflect on scripture and theology; plan and conduct public worship services; preside over sacraments such as the Lord's Supper; and perform memorial services as required. This description of duties, albeit incomplete, is worth noting for those organizations that employ individuals with a similar type of job. Organizations may wish to compare their job description with that analyzed in the decision, and redraft the job description, if necessary, in order to comply with IT-141R and paragraph 8(1)(c).

In relation to the term "congregation", the Directorate was concerned that the taxpayer was teaching academic instruction to the students attending the campus ministry as opposed to providing religious instruction. Paragraph 17 of IT-141R provides that, "[t]eaching at an educational institution, whether or not it is a denominational school, college or seminary, is not by itself recognized as ministering to a congregation." Referring to the decision of Bowman J. in *Bissell v. The Queen*,[24] the Directorate stated that while it is possible for teaching to involve a component of ministering, teaching in and of itself is not ministering.[25] Students assembled for academic instruction are not being provided with "spiritual counselling, advice, illumination and inspiration"[26], and thus are not a "congregation" within the

[22] Canada Revenue Agency, Document no 2011-039555I7, "Clergy residence deduction" (5 April 2011).
[23] (1999), 99 D.T.C. 707 (T.C.C.).
[24] [1999] T.C.J. No. 129, 99 D.T.C. 721 (T.C.C.) [*Bissell* cited to T.C.J.].
[25] *Ibid*., para. 43.
[26] *Ibid*.

meaning of the ITA. The Directorate also added it is permissible for the taxpayer's ministerial duties to include teaching, as long as it is "incidental to his duties of imparting spiritual and religious instruction". However, based on the specific information provided by the taxpayer, all of which was redacted in the published decision, the Directorate ultimately held that the taxpayer was ministering to a congregation, notwithstanding the ministry was at a university setting, and thus was eligible for the CR Deduction.

4. Student Ministries Associate Ineligible for the CR Deduction

In the fourth ruling[27], dated June 13, 2011, the issue was whether an individual employed as a full-time Student Ministries Associate with a particular organization qualified for the CR Deduction. Ultimately, the Directorate was unable to reach a conclusive position on whether the eligibility requirements were met because insufficient information was provided in relation to both the status and function tests. This decision points out the need for organizations to ensure that position descriptions are detailed and that they are accompanied by an explanation of why they comply with the requirements under the ITA.

The taxpayer claimed that the status test was met because he or she was a "regular minister". In response, the Directorate quoted paragraphs 3 to 6 of IT-141R, which define "member of the clergy or regular minister". In summary, those paragraphs describe the three-part test for a "regular minister": (i) authorization or empowerment to perform spiritual duties, conduct religious services, administer sacraments and carry out similar religious functions; (ii) appointment or recognition by a body or person with legitimate authority to appoint or ordain ministers on behalf of or within the religious organization; and (iii) a position or appointment of some permanence.[28]

A "member of the clergy" is similar to a regular minister to the extent that it requires: (i) a serious and long-term commitment to the ministry; and (ii) a formal or legitimate act of recognition.[29] One key difference, however, is that it is not mandatory for a member of the clergy to be appointed by a

[27] Canada Revenue Agency, Document no 2011-0394051E6, "Clergy residence deduction" (13 June 2011).
[28] *Supra* note 2 at para. 5.
[29] *Ibid*., para. 4.

superior in the ecclesiastical hierarchy.[30] Another one is that a member of the clergy must be a "person set apart from the other members of the church or religious denomination as a spiritual leader."[31]

While the lack of detail provided by the taxpayer and the lengthy quoting of the IT-141R in response do not add to our understanding of the Directorate's approach to the CR Deduction, the decision does highlight some key case law on the meaning of "member of the clergy or regular minister".

In *Côté v The Queen*[32], the Tax Court of Canada held that a part-time youth pastor at the level of lay preacher was not a regular minister of a religious denomination. The taxpayer had completed his Bible studies to obtain a ministry license and become an ordained minister, but was at the level of a lay preacher.[33] The Tax Court stated that paragraph 8(1)(c) did not require the taxpayer to perform full-time duties in contrast to a taxpayer engaged in administrative service for a religious denomination.[34] It also did not require a taxpayer to be the head of a ministry for a congregation. The Tax Court explained that in church hierarchy, there are certain duties and powers accorded to particular positions.[35] It went on to state that the relevant issue was whether the taxpayer was a regular minister of the religious denomination.[36]

In order to be a "regular minister" a person must be a member of a group or class within a denomination "that is acknowledged by that denomination as having a superior and distinct standing of its own in spiritual matters"[37]. The Tax Court acknowledged that while churches have lay members who assist members of the clergy or perform quasi-ecclesiastical duties, those activities did not make them a regular minister. To determine whether a person is a member of a group that has a superior and distinct standing of its own in spiritual matters in his church, the court would need to know how a particular church or religious denomination is organized.[38] Since the taxpayer did not provide evidence

[30] *Ibid*.
[31] *Ibid*.
[32] [1998], T.C.J. No. 762, [1999], C.T.C. 2152 (T.C.C.) [*Côté* cited to T.C.J.].
[33] *Ibid*., at para. 10.
[34] *Ibid*., at para. 17.
[35] *Ibid*., at para. 18.
[36] *Ibid*.
[37] *Ibid*., at para. 20.
[38] *Ibid*., at paras. 22-23.

regarding the organization of his religious denomination, the court held that he was not a regular minister.

The Directorate analogized the Côté case to the facts at hand to find that the taxpayer was not a regular minister. Similar to the Côté case, the evidence submitted by the taxpayer did not show how his or her religious organization was organized. To be specific, the Directorate stated that it was not provided with sufficient information to determine whether the taxpayer met the criteria to be a regular minister.

D. PRACTICAL IMPLICATIONS

Two practical implications arise from the technical interpretations summarized in this bulletin.

1. Informed decision-making by employers

Employers must decide whether they should sign Form T1223 Clergy Residence Deduction ("Form T1223"). In order to claim the CR Deduction, the taxpayer may, if required in the circumstances,[39] fill out Parts A and C of Form T1223. The employer of the taxpayer must fill out Part B, which requires the employer to certify that the taxpayer met the requirements under paragraph 8(1)(c) of the ITA. Employers may be liable to a penalty pursuant to ss. 163.2(3) of the ITA for making, furnishing, or participating in the making of a statement that they know, or would be reasonably expected to know, but for circumstances amounting to culpable conduct, is a false statement that could be used by another person for the purposes of the ITA. Therefore, employers must do their due diligence and carefully assess whether the eligibility requirements are met.

2. Complete applications

Organizations should not seek a tax ruling from the Directorate unless they have carefully prepared their application and double-checked whether the requirements are satisfied. Incomplete applications that are hastily prepared may result in a ruling that the CR Deduction does not apply, and trigger a reassessment by the CRA to investigate whether the deduction has been improperly claimed.

[39] Only under certain circumstances is it necessary for the taxpayer to fill out Form 1223. See Canada Revenue Agency, Registered Charities Newsletter, No 23, "Guest piece: clergy residence deduction" (June 2005), online: Canada Revenue Agency <http://www.cra-arc.gc.ca/E/pub/tg/charitiesnews-23/charitiesnews-23-e.html>. See Terrance S. Carter, "Clarification regarding CRA Requirements for Clergy Residence Deduction" Charity Law Update (September 2009), online: Carters Professional Corporation, <http://www.carters.ca/pub/update/charity/09/sep09.pdf>.

E. CONCLUSION

This series of technical interpretations summarized in this bulletin are in keeping with the Directorate's past approach to interpreting paragraph 8(1)(c) of the ITA and IT-141R. They illustrate the need for organizations to be informed about the requirements for the CR Deduction, to carefully assess their operations and make appropriate adjustments where needed to meet the requirements. Organizations should not blindly fill out the Form T1223 without conducting their due diligence. From the perspective of the taxpayer who will be applying to the Directorate, it is critical to provide the latter with a careful and complete presentation of the facts on which the claim for the deduction is based or risk the possibility of being found ineligible based on insufficient facts.