
WATERLOO WELLINGTON ESTATE PLANNING COUNCIL

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Recent Changes to the *Income Tax Act* And Policies Relating to Charities and Charitable Gifts

(Power Point Presentation)

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OVERVIEW OF PRESENTATION

- Introduction
- Summary of Additions and Changes to CCRA Website in 2002 & 2003
- Selected Discussion of Income Tax Amendments Affecting Charities
- Selected Discussion of New Policies From CCRA Affecting Charities
- Other New Developments

Note: This power point presentation provides a summary of a paper entitled “Recent Changes to the *Income Tax Act* and Policies Relating to Charities and Charitable Gifts” available at www.charitylaw.ca

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B. SUMMARY OF ADDITIONS AND CHANGES TO CCRA WEBSITE IN 2002 & 2003

- Refer to: www.ccra-adrc.gc.ca/tax/charities/menu-e.html for all CCRA resource materials
- Changes to the CCRA website cover the following topics:
 - Legislative Amendments
 - Circulars
 - Information Letters
 - Policy Statements
 - Bulletins
 - Brochures and Guides
 - Newsletters
 - Summary Policies

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- Guidelines
 - Fact Sheets
 - Interim Memorandum
 - Consultation Papers
 - Future Directions
 - Press Releases
 - Joint Regulatory Table Report
- **What follows is a synopsis, current to December 31, 2003, of all publications published by CCRA with regards to charities in 2002 and 2003**

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C. DISCUSSION OF INCOME TAX AMENDMENTS AFFECTING CHARITIES

1. New Definition of Gift

- **The traditional common law definition of a gift requires:**
 - **The donor must have an intention to give**
 - **There must be a transfer of property**
 - **The transfer must be made voluntarily without contractual obligation**
 - **No consideration or advantage can be received by the donor**

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- **Therefore a contract to dispose of property to a charity at a price below fair market value would not generally be considered a gift at common law for which a charitable receipt could be issued for the difference in price**
- **Similarly, a gift to a charity that entitles the donor to receive a benefit of a material nature would not be a gift at common law for which a receipt could be issued even if the value of the gift significantly exceeded the benefit received**

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- **Draft amendments to the *Income Tax Act* in December of 2002 creates a new concept of “gift” for tax purposes which permits a donor to receive a tax credit under the Act even though the donor receives a benefit, provided that the value of the property exceeds the benefit received by the donor**
- **The idea that a gift can provide a benefit back to the donor is foreign to the common law concept of a gift**
- **The draft amendments reflect an importation of the civil law concept of gift which permits a benefit back to the donor**

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- **While a gift with an advantage may be deemed a gift under the *Income Tax Act*, it will not be a gift at common law and therefore there will be no transfer of title**
- **Utilizing a contract in order to transfer title may raise questions of donative intent that could preclude a gift for tax purposes**
- **In order to document the transfer of title where there is an advantage to the donor, and the expectation of a charitable receipt, the alternative of doing so by making use of a charitable trust could be considered**

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2. New Split-Receipting Rules

- **The key requirements of what will be recognized as a gift for income tax purposes for split receipting based on the new definition of gift are as follows:**
 - **There must be voluntary transfer of property with a clearly ascertainable value**
 - **Any advantage received by the donor must be clearly identified and its value ascertainable**

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- **There must be a clear donative intent by the donor to benefit the charity**
- **Donative intent will generally be presumed provided that the fair market value of the advantage does not exceed 80% of the value of the gift**
- **The eligible amount of a gift will be the excess of the value of the property transferred over the amount of the advantage received by the donor**

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- **The amount of the advantage is the total value of all property, services, compensation or other benefits to which the donor is entitled as partial consideration for the gift**
- **Excluded from the value of the advantage is token consideration for the gift calculated on the basis of a “*de minimis* threshold” of the lesser of 10% of the value of the gift and \$75.00**
- **The charitable receipt will now need to identify the advantage and the amount of the advantage as well as the eligible amount of the resulting gift**

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- A receipt can be issued where the advantage received by the donor (less any token consideration based upon the “*de minimis* threshold” of the lesser of 10% of the value of the gift and \$75.00) does not exceed 80% of the value of the gift.
- December 20, 2002 and December 5, 2003 announcements introduced proposed legislation to implement split-receipting provisions in the *Income Tax Act*
- For example, the ticket price for a table of 8 at a fundraising dinner is \$2,000.00, the fair market value of the dinner is \$800.00, the value of complimentary items; i.e., the door prizes and table gifts is \$300.00

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Total price for a table of 8	\$2000.00
Less:	
- value of dinner	\$800.00
- complimentary items	<u>\$300.00</u>
(complimentary items exceed the lesser of 10% of \$2000.00 or \$75.00)	
Total value of advantage received by the donor	<u>\$1,100.00</u>
Eligible amount of charitable receipt	<u>\$ 900.00</u>

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3. Charitable Annuities:

- **CCRA indicated in Technical News No. 26 that the previous administrative position with regard to charitable annuities has no basis in law and cannot be continued as a consequence of the amendment to subsection 248(33) of the *Income Tax Act***
- **Instead, a new administrative policy has been proposed which provides for a charitable receipt based on the difference between the cost of the annuity and the gift, rather than the difference between the anticipated annuity payments and the amount of the gift**

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Facts:

- **A donor makes a \$100,000 contribution to a charitable organization**
- **The donor's life expectancy is 8 years (and the donor lives 8 years)**
- **The donor is to be provided annuity payments of \$10,000 per year (total of \$80,000)**
- **The cost of the annuity to provide the \$80,000 payment over 8 years is \$50,000**

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<u>Former tax treatment under IT-111R2</u>	<u>Proposed tax treatment under Technical News No. 26</u>
<ul style="list-style-type: none"> • the donor receives a tax receipt of \$20,000 for the year of donation, being the amount of \$100,000 in excess of the annuity payments of \$80,000 • All of the \$80,000 annuity payments are tax free 	<ul style="list-style-type: none"> • the donor receives a tax receipt of \$50,000 for the year of donation, being the amount of \$100,000 in excess of the \$50,000 cost to provide the annuity • \$30,000 of the \$80,000 annuity payments will be included as income of the donor over 8 years, with the balance of the \$50,000 to be tax free

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- However, CCRA indicated that the administrative policy set out in IT-111R2 will continue to apply to annuities that were issued prior to December 21, 2002.
- The expectation of CCRA that, notwithstanding the withdrawal of this administrative policy, “charitable annuities are likely to continue as a means of fund raising, and may well be more advantageous to the donor” remains to be seen

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4. New Definition of Charitable Organizations and Public Foundations

- **In the December 2002 draft amendment, the definitions of charitable organizations and public foundations were amended by replacing the “contribution” test with a “control” test**
- **The rationale for amending the definitions is to permit charitable organizations and public foundations to receive large gifts from donors without concern that they may be deemed to be a private foundation**

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- **The previous “contribution” test meant that where more than 50% of the capital of a charity was contributed from one donor or donor group then the charity would be deemed to be a private foundation subject to more stringent activity and disbursement requirements**
- **The new “control” test means that while a donor may donate more than 50% of the capital of a charity, the donor or donor group cannot exercise control directly or indirectly in any manner over the charity or be in a non arms length relationship with 50% or more of the directors or trustees of the charity**

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- **As a result of the introduction of a “control” test, the convoluted business rules in relation to “control” will become applicable as a result of the phrase “controlled directly or indirectly in any manner whatever”**
- **Charities will now need to be careful that they do not unwittingly become designated as a private foundation instead of either a charitable organization or public foundation**

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5. Extended Definition of Tax Shelter

- **A tax shelter was defined under the *Income Tax Act* as any property for which a promotion represents that an investor can claim deductions or credits which equal or exceed the actual amount of the investment within four years of its purchase**
- **The definition of tax shelter was amended in the February 2003 Budget to include tax credits on charitable donations and debts incurred for which recourse is limited**
- **This mean that tax shelter donation programs with promises of net return on investments will need to be registered as tax shelters**

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- **The potential misuse of tax shelter donation programs continue to be scrutinized by CCRA and are not limited to only “art flips”**
- **The position of CCRA is set out in a CCRA Fact Sheet entitled “Art-Donation Schemes or ‘Art-Flipping’”. The mechanism commonly utilized in these schemes is explained as follows:**
 - **Step 1: A promoter gives a person the opportunity to purchase one or more works of art or another item of speculative value at a relatively low price and works with the person in donating the items to a Canadian registered charity**

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- **Step 2: The person donates the art or other item and receives a tax receipt from the charity that is based on an appraisal arranged by the promoter that is substantially higher than fair market value**
- **Step 3: When the person claims the receipt on his or her next tax return, it generates a tax saving that is higher than the amount paid**
- **These donation programs turn on the fact that the item in question is purchased at a substantially lower price than its much higher fair market value, and that a donation receipt is issued by a registered charity for the fair market value when the item is donated to it**

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- **CCRA’s position with respect to tax shelter donation programs**
 - **CCRA’s Fact Sheet entitled “Canada Customs and Revenue Agency Reminds Investors of Risks Associated with Tax Shelters” states that registration as a tax shelter “does not indicate that the CCRA guarantees an investment or authorizes any resulting tax benefits” and that “CCRA uses this identification number later to identify unacceptable tax avoidance arrangements”**

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- **CCRA’s Fact Sheet concerning Art-Donation Schemes or ‘Art-Flipping’ indicates that third party penalty can include charities that receive the donation if “it knows – or if it can reasonably be expected to have known – that the appraised value were incorrect”**
- **The December 5, 2003 draft amendments to the *Income Tax Act* also apply to the tax shelters provisions which would limit tax benefits from charitable donations made under tax shelter donation arrangements**

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- **The proposed amendments generally set out a three year limit in which property donated in a tax shelter program will be valued at a donor's cost to acquire the property, changing the value of the donations to the actual purchase price of the donated items rather than the appraised value during the three year period**
- **The proposed December 5, 2003 amendments, if passed, will apply to gifts made on or after December 5, 2003**

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- **The December 5, 2003 draft amendments also preclude charitable receipts for limited-recourse debt in respect of gifting arrangements**
- **Limited recourse debt is a form of tax shelter in which the tax payer incurs a debt, for which recourse is limited and which debt can reasonably be considered to be related to a charitable gift**
- **The proposed amendments in relation to limited recourse debt, if passed, will apply to gifts made on or after February 19, 2003**

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- **Where a charity has been involved in a tax shelter donation scheme prior to the announcement of proposed changes to the ITA provisions on December 5, 2003, the following are some of the issues that the charity may want to consider:**
 - **Tax shelter registration does not in itself give the donation program any protection**
 - **Possible difficulties in establishing fair market value of goods donated**
 - **The onus is on the charity to arrange a qualified appraisal of the donation, not on the promoter or the donor**
 - **There may be an issue of donative intent by the donor**

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- **It is important to determine whether the donations are gifts of capital or inventory, determined preferably by means of an independent tax opinion**
- **Possible third party penalties levied against a charity for improper valuation of the fair market value of items donated**
- **Potential assessment challenges of donors by CCRA**
- **Potential problems in complying with a charity's disbursement quota**
- **Due diligence requirements on the part of the charity in receiving, monitoring and disbursing products that are donated**

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- **The need for the charity to obtain independent legal advice**
- **Where a legal defence fund is promised, questions of sufficiency need to be considered and whether it is available for the benefit of the charity as opposed to donors**
- **Possible loss of charitable status by the charity**
- **Possible exposure of directors to personal liability to donors who are reassessed**

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6. Revocation of Registration of Charities

- **Pursuant to the December 2002 Amendments, subsection 149.1(2), (3) and (4) have been amended to permit the revocation of the charitable status if a charity “*makes a disbursement by way of a gift*” which is not a gift made “*in the course of charitable activities carried on by it*” or not a gift “*to a donee that is a qualified donee*” at the time of the gift**
- **All gifts made by a charity must be in the course of furthering its charitable activities or paid only to qualified donees**

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D. SELECTED DISCUSSION OF NEW POLICIES FROM CCRA AFFECTING CHARITIES

1. New Policy Statement on Political Activities

- **The courts have held that an organization that has been established for a political purpose cannot be a registered charity. Political purposes have been defined by the courts as purposes seeking to:**
 - **Further the interests of a particular political party; or support a political party or candidate for public office;**
 - **Retain, oppose, or change the law, policy or decision of any level of government in Canada or a foreign country**

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- **A charity’s ability to participate in political activities have been controversial and highly confusing for a long time**
- **CCRA’s Policy Statement on Political Activities gives clarification to charities from a administrative, not legislative standpoint**
- **The Policy Statement gives a broader interpretation of what are charitable activities as opposed to political activities**
- **CCRA has established three categories of involvement by charities in political activities:**
 - **Charitable activities**
 - **Prohibited activities**
 - **Permitted political activities**

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- **Examples of charitable activities:**
 - **Distributing the charity’s research on a particular topic relevant to its charitable purpose**
 - **Releasing and distributing a research report to election candidates**
 - **Publishing a research report online**
- **Examples of prohibited activities:**
 - **Supporting an election candidate in the charity’s newsletter**
 - **Distributing pamphlets that underline the government’s lack of contribution to the charity’s goals**
 - **Preparing dinner for campaign organizers of a political party**
 - **Inviting competing election candidates to speak at separate events**

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- **Examples of permitted political activities:**
 - **Buying a newspaper advertisement to pressure the government**
 - **Organizing a march to Parliament Hill**
 - **Organizing a conference to support the charity’s opinion**
- **Limits on using charitable resources for permitted political activities:**
 - **Under the ITA, a charity must devote substantially all of its resources to charitable activities**

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- **Substantially “all” is defined by the CCRA as 90% or more, meaning that a charity may not devote more than 10% of its total resources per year to political activities**
- **Smaller charities with less than \$50,000 annual income can devote up to 20% of their resources to political activities; income between \$50,000 and \$100,000 can devote up to 15%, and income between \$100,000 and \$200,000 can devote up to 12%**
- **Resources used towards permitted political activities are not applied to meeting a charity’s disbursement quota for receipted donations**

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2. New Policy on Business Activities

- **Running a business is generally not a charitable activity**
- **However, a related business will be permitted subject to certain limitations**
- **A related business is defined as a business activity connected to a charity that is used in the furtherance of the charity’s charitable purposes**
- **There are two kinds of related businesses:**
 - **Businesses that are linked to a charity’s purpose and subordinate to that purpose, such as:**

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- **A hospital’s parking lots, cafeterias, and gift shops for the use of patients, visitors, and staff**
- **Gift shops and food outlets in art galleries or museums for the use of visitors**
- **Book stores, student residences, and dining halls at universities for the use of students and faculty**
- **Therefore, a church that operates a bible book store would likely be carrying on a permitted related business because the selling of bibles is related to the charitable purpose of the church**

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- **Businesses that are run substantially by volunteers, i.e. 90% are volunteers, are deemed to be a related business even if the business is not linked to the charitable objects of the charity**
- **Unrelated business: Is a business activity that is neither related nor deemed related, i.e. if a church decides to buy and sell computers for profit, or run a catering business with paid employees.**
- **Charities cannot participate in unrelated businesses, as they risk being refused or losing charitable registration status**

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3. New Policy on Promoting Racial Equality

- **Until recently, the common law did not recognize promoting racial equality as charitable**
- **In recent years, both legislation and public policy in Canada has recognized and supported the promotion of racial equality and positive ethno-cultural relations**
- **Now charities that promote racial equality can be registered under the *Income Tax Act*, either under the head of “advancement of education” or under the head of “other purposes beneficial to the community”**

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- **Examples of acceptable activities under Advancement of Education**
 - **Programs that educate about individual or systemic racism**
 - **Development of curriculum materials for anti-racism or diversity training and leadership programs**
- **Examples of acceptable activities under Purposes Beneficial to the Community**
 - **Raising public awareness by disseminating factual, well-reasoned information as part of the group’s outreach, such as using brochures and web sites**
 - **Establishing and maintaining peer support groups among [name of intended group] as well as member of the public**

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4. New Policy on Relieving Poverty by Providing Rental Housing for Low-Income Tenants

- **Organizations that relieve poverty by providing rental housing for low-income tenants are eligible for charitable registration even though up to 10% of their housing units are rented at FMV and in some limited situations up to 33% can be rented at FMV**
- **Some not-for-profit organizations that were not charities will now qualify to be charities and therefore will need to apply for charitable status, alternately they may become taxable**

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- **Under the Policy, the definition of the beneficiary class is integral to understanding the document as a whole. Beneficiary class is defined as “a class of poor, needy, necessitous, underprivileged, low-income, in financial need, of small/limited means, or an acceptable synonym”**
- **It is clear that the term “beneficiary” has been widely rather than narrowly construed, as CCRA is intending to give wider latitude to applicants for charitable registration.**
- **It will likely be easier to characterize the intended beneficiary class in order to meet CCRA requirements, as “acceptable synonym” can be used to describe people of limited means**

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5. New Policy on Donation of Gift Certificates

- **CCRA has outlined a number of situations under which a charity may issue an official donation receipt for the donation of a gift certificate, including:**
 - **Where the donor purchases or obtains the gift certificate directly**
 - **Where the issuer of the gift certificate directly donates a gift certificate to the charity, and the charity, not a third party, redeems the certificate for property**

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6. New Policy on Holding of Property for Charities

- **CCRA has recognized that organizations that hold title for registered charities can be registered as charities themselves**
- **Charities may want to use charitable title-holding organizations in order to protect their assets from liability associated with operation**

7. New Policy on Third Party Fundraisers

- **A charity can use a third party organization or fundraiser as an agent to organize a fundraising event, but the charity must retain control over all monies earned and all receipts issued in relation to the event**

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8. Summary Policies

- **Examples of Summary Policies affecting charities include:**
 - **Ten year gifts**
 - **Religion**
 - **Broad & vague objects**
 - **Restricted funds**
 - **Confidentiality**
 - **Directors/trustees**
 - **Conditional gift**
 - **Designated gift**

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E. OTHER NEW DEVELOPMENTS

1. Documents of Public Record

- **Information returns submitted by charities are now available on-line, save and except for any portions of the return designated as confidential**
- **Charities' board of directors are advised to ensure the accuracy of their reporting when completing their new shorter T3010A returns and to verify their records on-line to ensure that the information available to the public is correct**

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2. Electronic services – example of services available from the Charities Directorate website

- **Electronic payments to CCRA through banking institutions**
- **T4 Internet filing service**
- **Cancellations and amendments in electronic format for information slips**

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