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# **AFP 2004 CONGRESS**

## **CURRENT LEGAL ISSUES IN FUNDRAISING**

**Toronto – December 2, 2004**

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- **Highlights of Proposed New Tax Rules Affecting Fundraising** – Terrance S. Carter
  - **Implications of Regulatory Reform Under the New Budget Proposals** – M. Elena Hoffstein
  - **New Privacy Legislation and Its Impact on Fundraising** – Mark J. Wong
  - **Estate Administration Issues With Charitable Gifts** – M. Elena Hoffstein
  - **Legal Liabilities in Fundraising** – Terrance S. Carter
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**(Power Point Presentations)**



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# AFP 2004 CONGRESS CURRENT LEGAL ISSUES IN FUNDRAISING

Toronto – December 2, 2004

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## Highlights of Proposed New Tax Rules Affecting Fundraising (Power Point Presentation)

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**Overview Of Presentation**

- Additions to CRA Website in 2004
- Highlights of Proposals in Draft Legislation Released February 27, 2004
- Highlights of Proposals in Draft Legislation Released September 16, 2004 Concerning Disbursement Quota Formula

For more information – see March 4, 2004 article entitled Recent Changes to the Income Tax Act and Policies Relating to Charities and Charitable Gifts and Charity Law Bulletin #41, # 54, #55, #56 and #59 at [www.charitylaw.ca](http://www.charitylaw.ca)

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**A. Additions To CRA Website In 2004**

- Refer to: [www.ccradrc.gc.ca/tax/charities/menu-e.html](http://www.ccradrc.gc.ca/tax/charities/menu-e.html) for all CRA resource materials
- CRA website includes the following areas:
  - Legislative Amendments      - Bulletins
  - Circulars                              - Brochures
  - Information Letters              - Newsletters
  - Policy Statements                - Summary Policies
  - Fact Sheets                            - Consultation Paper

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- New and forthcoming policy statements from CRA
  - New Proposed Policy Statement on Applicants Assisting Ethnocultural Communities
  - New Proposed Policy Statement on Meeting the Public Benefit Test
  - New Publication Entitled “Charities in the International Context”

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- Forthcoming Policy Statement on Decision-making process for Public Benefit
- Forthcoming Policy Statement on Human Rights as a Charitable Purpose
- Forthcoming Policy Statement on Umbrella Organizations
- Forthcoming Policy Statement on Sports-related applicants
- Forthcoming Policy Statement on Research as a Charitable Activity

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**B. Highlights Of Proposals In Draft Legislation Released February 27, 2004**

Revised Draft Technical Amendments to the *Income Tax Act* were introduced on February 27, 2004 reflecting proposed changes in December 2002, February 2003 and December 2003, which are summarized below as follows

**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

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- The transfer must be made voluntarily without contractual obligation
- No consideration or advantage can be received by the donor
- Draft amendments to the *Income Tax Act* create a new concept of "gift" for tax purposes, which permits a donor to receive a tax credit under the *Income Tax Act* even though the donor receives a benefit, provided that the value of the property exceeds the benefit received by the donor

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- However, 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
- While a gift with an advantage may be deemed a gift under the *Income Tax Act*, it will not necessarily be a gift at common law and therefore should not be identified as a gift in order to avoid subsequent challenges to the validity of the gift

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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 reflected above 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, or a person not dealing at arms length with the donor, has received or obtained or is entitled to, either immediately or in the future as partial consideration for or in gratitude for the gift or that is in any other way related to 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

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- 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
- The advantage can be received prior to, at the same time as, or subsequent to the making of the gift
- It is not necessary for a causal relationship to exist between the making of the gift and the receiving of the advantage as long as they are “in any other way” related to each other

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- Therefore, if a donor makes a gift in consideration of the charity employing his spouse, or the charity hires his spouse in gratitude of the gift being made in the future, then the value of the advantage could arguably include the current value of the employment of the spouse
- In addition, the advantage in question could even be provided by third parties unbeknownst to the charity, which fact may necessitate that charities make inquiries of donors if they have received a related benefit from anyone

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**3. The Evolving Shutdown of Tax Shelter Donation Programs**  
**Definition of Tax Shelter:**

- A tax shelter is defined under the *Income Tax Act* as any property for which a promoter 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 limited recourse debt
- This meant that tax shelter donation programs with promises of net return on investments were required to be registered as tax shelters

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**Description of Tax Shelter Donation Programs:**

- The potential misuse of tax shelter donation programs has been identified by CRA
- A tax shelter donation program commonly involves the following scheme
  - Step 1: A promoter gives a person the opportunity to purchase an item of speculative value, like comic books, 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 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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**Proposed Amendments to the *Income Tax Act*:**

- **The December 2003 and February 2004 proposed amendments to the *Income Tax Act* attempt to shut down tax shelter donation programs by severely restricting the tax benefits from donations made under tax shelter donation arrangements**

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**New Deeming Provision:**

- **The proposed amendment deems the fair market value of property donated for the purpose of issuing charitable receipts to be the lesser of (i) the fair market value of the property and (ii) the cost (or the adjusted cost base where applicable) of the property to the tax-payer immediately before the gift is made in the following three situations:**

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- **If the tax-payer acquires the property through a “gifting arrangement” where it is represented that the acquisition of the property would generate any combination of tax credits or deduction that in total would equal or exceed the cost of acquiring the property in question, whether or not it was acquired within three years**
- **If the tax-payer acquired the property less than three years before the gift was made**

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– If it was reasonable to conclude that when the tax-payer acquired the property, the tax-payer expected to make a gift of the property, with the donor possibly having to prove that the donor did not have an expectation to make a gift when the property was acquired

- The deeming provision does not apply to inventory, real property situated in Canada, certified cultural property, publicly traded shares and ecological gifts

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- The deeming provision also does not apply to situations where the gift is made as a consequence of the donor's death
- The proposed December 2003 amendments with regards to gifts of property, if passed, will apply to gifts made on or after December 5, 2003

**Limited Recourse Debt:**

- The December 2003 draft amendments also preclude charitable receipts for limited recourse debt in respect of gifting arrangements

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- Limited recourse debt is a form of tax shelter in which the tax-payer incurs a debt for which recourse is limited and which can reasonably be considered to be related to a charitable gifting arrangement
- Even in situations where the recourse is not limited, the debt may be deemed to be a limited recourse debt unless the arrangement is in writing to repay the debt within 10 years and interest is paid annually within 60 days of the debtor's taxation year at not less than CRA prescribed rate
- If a gift includes a limited recourse debt, then the amount of the loan would be deducted from the amount of the gift

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**Substantive Gifts:**

- The Substantive Gift Amendment prevents a donor from avoiding the application of the Deeming Provision by disposing of property to a charity and then donating the proceeds of disposition, rather than the donor donating the property directly to the charity
- In this situation, the Deeming Provision in subsection 248(35) would apply and the fair market value is “deemed” to be the lesser of the fair market value of the substantive gift and the cost, or if the substantive gift is capital property of the tax-payer the adjusted cost base, of the substantive gift to the tax-payer immediately before disposition

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**Anti-Avoidance Rule:**

- In addition to the deeming provision, the December 2003 draft amendments introduced an anti-avoidance rule in subsection 248 (37) that if one of the reasons for a series of transactions that includes a disposition or acquisition of property is to increase the amount of the FMV of the gift, then the cost of the property for receipting shall be deemed to be the lowest cost to the donor to acquire the property in question or “an identical property” at any time

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**Practical Implications:**

- Charities will be required to inquire of donors of gift in kind when the property donated was acquired by the donors. Where possible, a written confirmation should be obtained from the donors to evidence the date of acquisition
- If the deeming provision applies, then the charity will need to inquire of the donor to determine the amount of the ACB of the gifted property, if applicable
- Charities may be required to inquire of donors of gifts in kind to determine whether the donors had an expectation to make a gift at the time when the donor acquired the property

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- Charities receiving gifts of private shares will need to determine if the shares were acquired within three years prior to the making of the gift or whether such shares had been exchanged for another class of shares i.e. in an estate freeze, either within three years or for the purpose of making a 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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**4. Revocation of Registration of Charities**

- Pursuant to the proposed December 2002 Amendments, subsection 149.1(2), (3) and (4) will be 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 made in the course of furthering its charitable activities or transferred only to qualified donees

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**5. Additional Qualified Donee**

- The February 27, 2004 Draft Amendments expand “qualified donees” to include a municipal or public body performing a function of a government in Canada
- This amendment is in response to the Quebec Court of Appeal decision in *Tawich Development Corporation v. Deputy Minister of Revenue of Quebec*, 2001 D.T.C. 5144

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**C. Highlights Of Proposals In Draft Legislation Released September 16, 2004 Concerning Disbursement Quota Formula**

**1. Overview**

- The 2004 Federal Budget (the “Budget”) includes proposals to remedy technical problems with disbursement quota
- Draft enabling legislation for the Budget was released on September 16, 2004 and includes significant changes to the calculation of the disbursement quota
- See Power Point presentation by Elena Hoffstein for a summary of Regulatory Reform provisions in September 16, 2004 draft legislation

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- The proposed changes to the disbursement quota in the September 16, 2004 draft legislation has made an already complicated formula totally unintelligible and unworkable
- The disbursement formula has been amended to provide as follows: (with amendments underlined)

$$A + A.1 + \underline{A.2} + B + \{C \times \underline{0.035}[D - (E + F)]\}/365$$

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**2. Proposed changes to Disbursement Quota Formula**

**Reduction of Disbursement Quota Rate**

- The good news is that the September 16, 2004 legislation proposes to reduce the 4.5% disbursement quota that currently applies to public and private foundations to a more manageable disbursement quota of 3.5%

**Extension of 3.5% Disbursement Quota to Charitable Organizations**

- In the past, only public and private foundations were subject to a disbursement quota upon its capital assets not used in charitable activities

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- The September 16, 2004 legislation proposes that the reduced 3.5% disbursement quota on surplus capital assets will also apply to charitable organizations registered after March 23, 2004 (after 2008 for charitable organizations registered before March 23, 2004)

**Realizing Capital Gains from Endowments**

- The September 16, 2004 legislation proposes to combine 10 year gifts and gifts of capital property from estates under the new term of “enduring property”

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- The September 16, 2004 legislation also introduces the concept of a “capital gains pool”, which is in essence consists of the amount of capital gains of a charity resulting from disposition of “enduring property”
- A charity will now be able to encroach on the capital of a ten year gift, provided that the terms of the gift so permit, up to the amount of the 3.5% disbursement quota, but for practical purposes is limited to the amount of the “capital gains pool”, since anything above the “capital gains pool” will be added back into the 80% disbursement quota for the charity

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- The combination of the new concept of “capital gains pool” and the limited ability to encroach on a ten year gift as part of “enduring property” will make the calculation of the disbursement quota complicated and difficult for charities to comply with
- The previous anomaly that 80% of the disbursement of the capital gain had to be added to the disbursement quota of a charity is now alleviated by reducing the 80% disbursement quota by the lesser of 80% of the capital gain realized on the disposition and 3.5% of capital assets not needed in charitable activities

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**Transfer of “Enduring Property”**

- “Enduring property” (which includes 10 year gift) is not included in the 80% disbursement quota in the following taxation year
- The September 16, 2004 legislation proposes that “enduring property” received by a registered charity from another registered charity will result in the same treatment of that gift as if the “enduring property” had been received directly from the original donor, i.e. 80% of it will not need to be expended in the following taxation year

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**Gifts Transferred to Charitable Organizations**

- The September 16, 2004 legislation proposes that all transfer of funds from one registered charity to another, including transfers to a charitable organization, will be subject to the 80% disbursement requirement, i.e. 80% of the gift must be expended in the following taxation year
- Previously charitable organizations were exempt from the 80% disbursement quota involving transfer of funds to other charities

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- Now gifts to charitable organizations will need to comply with the specified gift rules in order to avoid having to expend 80% in the following taxation year unless it is a transfer of “enduring property”
- However, problems in the disbursement quota formula can occur for the transferring charity if an enduring property is designated in the transfer as a specified gift

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**3. Gifts Made By Way Of Direct Designation**

- Where an individual has designed in his/her will a charity as a direct beneficiary of the individual's RRSP, RRIF or life insurance policy, the September 16, 2004 legislation proposes to treat such gifts as "enduring property" for the purposes of the disbursement quota rules
- This will mean that direct designation of RRSP, RRIF and life insurance proceeds will be subject only to the 3.5% disbursement quota while they are held as capital and then subject to the 80% disbursement quota requirement in the year in which they are disbursed

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