
**INSTITUTE OF CHARTERED ACCOUNTANTS
OF ONTARIO**

**DIRECTOR AND OFFICER LIABILITY AND
BEYOND**

Toronto – December 6, 2005

- 1. The Legal Duties of Directors of Charities and Not-for-Profits**
 - 2. Good Governance in Meeting the Duties of Directors of Charities and Not-for-Profits**
 - 3. Due Diligence in Avoiding Risks for Directors of Charities and Not-for-Profits**
 - 4. How to Avoid Liability in Fundraising**
-

By Terrance S. Carter, B.A., LL.B.

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INSTITUTE OF CHARTERED
ACCOUNTANTS OF ONTARIO
**DIRECTOR AND OFFICER LIABILITY
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Part I
**The Legal Duties of Directors
of Charities and Not-for-Profits**

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A. OVERVIEW OF TOPICS

- Introduction
- Common Law Duties and Liabilities
- Statutory Duties and Liabilities

Note: For a more detailed discussion, see attached Summary “A” entitled “The Legal Duties of Directors of Charities and Not-for-Profits”

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B. DEFINITION OF DIRECTOR AND OFFICER

- For this presentation, references to corporation include an unincorporated association or a trust
- A director is generally anyone who takes on the role of the directing mind of a corporation
- A director can be known as a trustee, governor, board member, or even an elder or deacon of a religious organization
- An officer carries out the day to day functions of the corporation at the direction of the board
- An officer can also be a director or can become a *de facto* director
- For purposes of this presentation, reference to director is deemed to include officer

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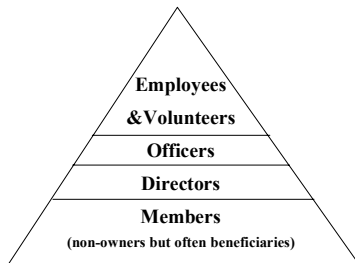
C. DIFFERENT TYPES OF CORPORATIONS

- **Share capital corporations**
(business corporation to make a profit)



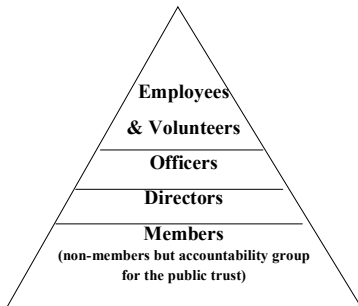
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- **Not-for-Profit Corporations**
(non profit purpose but not charitable)



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- **Charitable Corporations**
(charitable purpose akin to a public trust)



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D. COMMON LAW DUTIES AND LIABILITIES

- **Management of the Corporation**
 - Directors are responsible for all aspects of corporations operations
 - To fulfill duties, directors must ensure:
 - Objects are properly carried out and activities comply with objects
 - Corporation’s financial stability and overall performance
 - Proper hiring and supervision of management and staff
 - Failure to act, i.e. inaction, can result in personal exposure to liability i.e. liability of Worldcom directors

- **Duty of Care**
 - Directors of all corporations must exercise certain standard of care in carrying out duties
 - But standard of care varies depending on type of corporation
 - **Business corporation**
 - Statutory objective standard of care
 - Reasonably prudent person

- **Not-for-profit corporation (non-charity)**
 - Common law subjective standard of care
 - Director’s own knowledge and experience important
 - *New Canada Not-for-Profit Corporations Act* will establish an objective standard of care
- **Charitable corporation**
 - Additional expectations beyond subjective standard
 - Directors of charities also subject to fiduciary duties as quasi-trustees of charitable property

- **Liability Risk for Lack of Corporate Authority**
 - Corporate authority defined by corporate objects in governing documents
 - All corporate activities must fall within parameters of these objects
 - Liability results where directors act outside scope of this authority

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- **Liability Risk for Negligent Mismanagement (Tort)**
 - Tort is civil wrong for which injured party can seek damages from the court
 - Directors can be personally liable for corporation's torts where own conduct or inaction contributed to victim's injury
- **Liability Risk in Contract**
 - Directors generally not personally responsible for contracts signed for corporation
 - However, need to have proper corporate authority to sign contracts and ensure contractual terms are complied with

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- **Liability Risk for Breach of Fiduciary Duty**
 - Overview
 - Directors of charitable corporations are subject to fiduciary duty to act as quasi trustee of charitable property
 - Directors of not-for-profit corporations also have fiduciary duties to put the interest of the corporation ahead of their own interest
 - Fiduciary duties owed to charitable objects, corporation, donors, members and creditors

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– Summary of fiduciary duties

- Duty to act honestly
 - Conflicts of interest to be avoided and disclosed
 - Directors must not act fraudulently
- Duty of loyalty
 - Director’s sole interest is to the corporation
 - Director’s interests not to be placed in conflict with those of corporation

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- Duty of diligence/duty to act in good faith
 - Directors to diligently attend to duties by being familiar with all aspects of corporation
 - Directors may have liability exposure at common law for failure to attend to their legal duties or those of the corporation
 - Where necessary, advice of qualified professionals should be sought
- Duty to exercise power
 - Directors responsible for managing corporation

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- Delegation to management, staff and volunteers is possible, but directors must always supervise
- Duty of obedience
 - Directors must comply with applicable legislation and the corporation’s governing documents
 - All valid corporate decisions must be implemented

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- **Duty to avoid conflict of interest**
 - **Conflicts of interests to be avoided**
 - **Directors must also avoid anything that gives director appearance of a personal benefit**
 - **Where conflicts occur, they are to be declared, director to not participate in discussions or vote, and may even have to resign**

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- **Duty of prudence**
 - **Directors with special expertise must use it prudently to achieve best result for corporation**
- **Duty to continue**
 - **Resignation as director will not relieve all obligations**
 - **May even constitute breach of trust**
 - **Independent legal advice should be obtained in considering resignation**

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- **Liability for Breach of Trust**
 - **Overview**
 - **In addition to fiduciary quasi trustee duties, directors of charitable corporations may also be trustees of some charitable property**
 - **However, fiduciary duties and trustee duties essentially the same**
 - **Recent *Aids Society* case emphasizes that directors have obligation to apply charitable property to charitable objects**

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- Where charitable property lost as a result of actions or inactions of directors, breach of trust could be found
- Potential liability risks
 - Remuneration of directors
 - In Ontario, directors of charitable corporations cannot receive direct or indirect remuneration, e.g. as employee or contractor, without court approval
 - Indemnification and directors' insurance now available

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- Dealing with charitable property
 - Directors responsible for handling of charitable property
 - Personal liability results where mismanagement occurs
- Dealing with charitable objects
 - Charitable property can only to be applied to charitable objects
 - Failure to properly apply charitable property may result in personal liability

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- Dealing with special purpose charitable trusts
 - Directors of charitable corporations have fiduciary obligations to donors
 - Liability for breach of trust possible where donor restrictions or terms of endowment funds are not complied with
- Investment of charitable funds
 - Directors have a duty to invest charitable property

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- Liability can result from failure to comply with investment powers as well as bad investments, overly conservative decisions and missed opportunities
- Co-mingling of donor restricted funds
 - Are gifts subject to restrictions or limitations?
 - Co-mingling of donor restricted gifts now possible under *Charities Accounting Act* (Ontario) regulations
 - See Charity Law Bulletin #4 at www.charitylaw.ca
 - But cannot co-mingle with general funds

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- E. STATUTORY DUTIES AND LIABILITIES**
- Overview
 - Many federal and provincial statutes impose offences and penalties for acts and omissions of corporate directors
 - Directors can be held personally liable, as well as jointly and severally, with other directors
 - Only defence is due diligence
 - Resigning as a director may not limit liability though there are generally limitation periods

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- Federal Statutes
 - *Canada Corporations Act*
 - Wages and vacation pay
 - Conflict of interest
 - Reporting requirements
 - Books, minutes and records
 - Identification of corporation
 - Membership lists
 - Winding up
 - General penalty

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– *Income Tax Act (Canada)*

- Directors jointly and severally liable to pay employee income tax deductions for two years after term of office
- Directors maybe personally liable if charity fails to comply with numerous reporting requirements, e.g. annual charity information return or improper charitable receipts, or for giving improper tax advice
- Directors may also face fines and imprisonment if they are involved in making false or deceptive statements or evading compliance with the *Income Tax Act*
- Avoid liability by showing positive steps taken to ensure compliance

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– *Excise Tax Act (Canada)*

- Directors jointly and severely liable for corporation’s failure to collect & remit GST
- Liability continues for two years after cease to be director

– *Canada Pension Plan*

- Joint and several liability where corporation fails to remit employee pension premiums

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– *Canadian Environmental Protection Act*

- Positive duties imposed on directors to ensure compliance in relation to air and water pollution as well as toxic substance storage and disposal
- Failure to comply could result in prison terms and fines

– *Anti-terrorism Legislation*

- Legislation has serious liability risks for charitable corporations and directors, particularly those involved in overseas work

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- Risks include seizure of charitable property, loss of charitable status and criminal code charges
- See www.antiterrorismlaw.ca
- *Criminal Code*
 - Bill C-45 (Westray Mines) for gross negligence in work place safety
 - Section 336 – criminal breach of trust
- Ontario Statutes
 - *Corporations Act (Ontario)*
 - Reporting requirements
 - Conflict of interest
 - General offence provision

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- *Employment Standards Act (Ontario)*
 - Fines imposed on directors for failure of corporation to pay wages, vacation pay and severances
 - 6 months liability for wages and 12 months liability for vacation pay, plus fines
 - However, limitation periods are available

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- *Retail Sales Tax*
 - Directors jointly and severally liable where corporation fails to remit
- *Workplace Safety and Insurance Board Act (Ontario)*
 - Directors are not liable for corporation’s failure to remit premiums unless it can be shown they did not intend to pay them

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– *Pension Benefits Act (Ontario)*

- Directors who fail to pay corporation premiums for employee’s pension plans and to hold monies in trust may be ordered to make up contribution
- Failure to comply may subject directors to fines

– *Ontario Health Insurance Program*

- Directors will be held personally liable for premiums and health tax not paid by corporation

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– *Occupational Health and Safety Act (Ontario)*

- Directors required to take reasonable steps to comply with workplace health and safety requirements
- Failure to do so will result in fines to corporation and its directors

– *Environmental Protection Act (Ontario) and Related Legislation*

- Directors required to take reasonable care to prevent unlawful discharge of contaminants

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- Persons in control of contaminants are responsible for cleanup and related costs
- Appropriate environmental audits need to be obtained before purchasing or receiving land

– *Child and Family Services Act (Ontario)*

- Failure to report child abuse is an offence
- A charitable corporation and its directors may be liable where employees fail to report abuse or where it occurs because of failure to monitor employees and operations

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– *Trustee Act (Ontario)*

- Act establishes that directors of charitable corporations have power and duty to invest assets of charity
- Investments must be in accordance with prudent investor standard
- See Charity Law Bulletin #8 at www.charitylaw.ca

– *Charities Accounting Act (Ontario)*

- Act gives rights to donor and Public Guardian and Trustee (PGT) to call directors to account for improper use of

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Charitable property as well as fundraising practices

- Co-mingling of donor restricted funds is permitted provided there is strict compliance with the act's requirements

– *Human Rights Code (Ontario)*

- Possible discrimination against employees
- Possible discrimination against members of the public, i.e. sexual orientation, as well as possible new exemption involving denial of same sex marriages for religious organizations

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- Fundraising
 - Specific charitable statutes concerning fundraising:
 - *Income Tax Act (Canada)*
 - *Charities Accounting Act (Ontario)*
 - *Charitable Gifts Act (Ontario)*
 - *Religious Organizations' Lands Act (Ontario)*
 - *Charitable Fund-Raising Act (Alberta)*
 - *Charitable Fund-raising Businesses Act (Saskatchewan)*

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- *Charities Endorsement Act (Manitoba)*
- *Charities Act (Prince Edward Island)*
- *Proposed ULCC Uniform Charitable Fundraising Act (see Charity Law Bulletin #79)*
- **General statutes affecting charitable fundraising:**
 - *Competition Act (Canada)*
 - *Privacy Act (Canada)*

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- *Insurance Act (Ontario)*
- *Loan and Trust Corporations Act (Ontario)*
- *Securities Act (Ontario)*
- *Trustee Act (Ontario)*
- *Business Name Act (Ontario)*

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DIRECTOR AND OFFICER LIABILITY AND BEYOND
Toronto – December 6, 2005

Part II
Good Governance in Meeting the Duties of Directors of Charities and Not-for-Profits

By Terrance S. Carter, B.A., LL.B.
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A. OVERVIEW OF TOPICS

- Why “Governance”?
- What Does “Governance” and “Good Governance” mean?
- How To Achieve Good Governance?

Note: For a more detailed discussion, see attached Summary “B” entitled “Good Governance in Meeting the Duties of Directors of Charities and Not-for-Profits”. See also the book by Donald J. Bourgeois entitled “The Law of Charitable and Not-for-Profit Organizations”, 3rd Edition

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B. WHY “GOVERNANCE”?

- Is there life after Enron and Worldcom?
- Tougher corporate governance laws are becoming the standard for business corporations
- The same need for governance applies to charities and not-for-profits as much, if not more than business corporations
- Accountability requires good governance

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C. WHAT DOES “GOVERNANCE” AND “GOOD GOVERNANCE” MEAN?

- **Governance is not the same as Good Governance**
- **“Governance” in the voluntary sector is:**
 - **“the processes and structures that an organization uses to direct and manage its general operations and program activities”**
- **Good Governance**
 - **Achieving desired results and achieving them in the right way**

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- **Elements of “Good Governance”:**
 - **Vision - envisioning the future**
 - **Direction - setting goals**
 - **Resources - securing resources**
 - **Monitoring - reviewing periodically**
 - **Accountability - ensuring efficient use of resources and reporting progress**

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D. HOW TO ACHIEVE GOOD GOVERNANCE?

Due Diligence Is the Key

- **In order to achieve good governance, the directors must exercise due diligence**
- **To do so directors must understand the basis for their duties and responsibilities:**
 - **Objects and activities of the charity**
 - **Common law duties**
 - **Statutes, regulations and policies under which the charity operates**
 - **Regulators who have jurisdiction over the charity**
 - **Financial position of the charity**

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Eight Areas That Are Key to Effective Good Governance:

1. Mission and Strategic Planning

- Carrying out the mission of the charity
- Mission statement and organizational goals must be consistent with the law, e.g.,
 - Letters patent
 - Constitution
 - By-laws
 - Trust deed
 - Other restrictions
- Periodic review

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2. Transparency and Communication

- Communicating to members, stakeholders and the public
- The board should:
 - Establish policies for communication and feedback
 - Establish code of ethics for the board
 - Establish complaint and grievance procedure
 - Meet regularly

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- Focus on ensuring accountability
- Keep proper minutes and corporate records
- Respond appropriately to requests for information
- Develop a privacy policy

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- 3. Organizational Structures**
- **Developing appropriate structures for the organization**
 - **Basic organizational structure documents include:**
 - Letters patent
 - Constitution of the charity
 - By-laws of the charity
 - Trust deed
 - **Proper and legal procedures for directors and members meetings**
 - **Audit committee for finance and legal liability**

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- 4. Board's Role**
- **Understanding of the board's role**
 - **Understanding the duties of directors**
 - **Developing a board governance policy**
 - **Developing a code of conduct for board members**
 - **Developing a conflict of interest policy for directors and officers**

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- 5. Fiscal Responsibility**
- **Maintaining fiscal responsibility by the board**
 - **Establishing a budget; monitoring and controlling expenditure; maintaining proper accounting books and records**
 - **Proper issuance of charitable donation receipts**
 - **Preparing and auditing financial statements**
 - **Proper management and protection of the assets of the charity**

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6. Human Resources

- **Effective management team to oversee human resources**
- **With respect to employees:**
 - **Ensuring compliance with employment legislation and workplace safety regulations**
 - **Establishing policies and procedures**
- **With respect to volunteers:**
 - **Screening volunteers**
 - **Establishing policies for recruitment and oversight**

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7. Implementing Assessment and Control Systems

- **Establishing a code of ethical conduct**
- **Establishing a framework of internal regulation**
- **Establishing periodic review and audit procedures**
- **Establishing an audit committee**
- **Establishing legal risk management procedures**
- **Establishing a legal risk management committee**

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8. Planning for Succession and Diversity of the Board

- **Orientation of new directors and diversity of the board**
- **Continuous education of directors**
- **Periodic internal review and audit**

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DIRECTOR AND OFFICER LIABILITY AND BEYOND

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Part III
Due Diligence in Avoiding Risks for Directors of Charities and Not-for-Profits

By Terrance S. Carter, B.A., LL.B.
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A. OVERVIEW OF TOPICS

- Due diligence in the choice of charitable structures
- Due diligence in relying upon statutory protection
- Due diligence in operations
- Due diligence in indemnification and insurance
- Other means of due diligence in reducing risk

Note: For a more detailed discussion, see attached Summary "C" entitled "Due Diligence in Avoiding Risks for Directors of Charities and Not-for-Profits". See also Chapter 6 Risk Protection by Terrance S. Carter in "Primer for Directors of Not-for-Profit Corporations" at

<http://www.carters.ca/pub/book/2002/dirprimch6.pdf>

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B. DUE DILIGENCE IN THE CHOICE OF CHARITABLE STRUCTURES

- Charities as unincorporated associations
 - Use of unincorporated association is simpler, faster and less expensive
 - But exposes members and leaders to personal liability

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- **Charities as Corporations**
 - Separate legal entity protects members from personal liability
 - Directors may still be exposed to personal liability from fiduciary and management responsibilities
- **Using a multiple charitable corporation structure**
 - Multiple charitable corporations can help to protect charitable assets in one charity and contain liabilities in another charity

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- Need integrated corporate structure and trade-mark licensing to avoid loss of control
- Multiple charitable corporations can include parallel foundations and associated operating charities
- Parallel foundations have become more common in protecting long term gifts and endowment funds as a result of recent case law

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- **Multi-tiered provincial or national charities**
 - Single corporate structure provides ease of administration, but results in greater risk of liability exposure for total assets of a single corporate entity
 - Multiple corporate structure reduces risk of liability, but top tier organization may still be exposed to liability where too much control is imposed or employer/employee relationship exists
- **Need to avoid overlapping board of directors to reduce the chance of crossover liability**

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C. DUE DILIGENCE IN RELYING UPON STATUTORY PROTECTION

- **Due diligence defence**
 - The new *Canada Not-for-Profit Corporation Act* will provide a due diligence defence
 - Will be available where a director exercises the care, diligence and skill of a reasonably prudent person
- **Protection from third party contractual liability**
 - Protection available for corporations under the *Canada Corporations Act (CCA)* but not under *Corporations Act (Ontario) (OCA)*
 - Protects directors and officers against contracts entered into within the scope of authority of directors or officers

- **Protection from conflict of interest**
 - Both CCA and OCA permit directors to remain on the board of directors where a director declares a conflict of interest
 - Common law rule, though, does not permit directors of a charity to remain on the board even if conflict of interest declared

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D. DUE DILIGENCE IN OPERATIONS

1. The Rights and Powers of a Director in Exercising Due Diligence

- **Corporate authority**
 - Directors need to know governing documents of the charity
 - Directors must not authorize *ultra vires* activities
 - Membership approval may be required for certain activities
 - Amendments to governing documents may be necessary

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- **Management access and control over the affairs of the corporation**
 - Directors are responsible for all aspects of operations of the charity
 - Directors must be proactive in management and not be limited to setting policy only
- **Proactive protection of charitable assets**
 - Directors have a fiduciary duty to protect charitable property

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- Need to invest in accordance with prudent investment standard under the *Trustees Act* (Ontario)
- Need to take an inventory of charitable assets
 - Review annual financial statements
 - Review bank statement and records
 - Review past and current restricted funds
 - Review property deeds
 - Comply with statutory requirements where applicable

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- Protecting and managing intellectual property
 - Registering trade-marks and copyright
 - Securing internet domain names
 - Proper marking of trade-marks and copyrights
 - Licensing of trade-marks and copyrights

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- **Fundraising**
 - Monitor fundraising costs compared to 80/20 disbursement quota for receipted gifts
 - Reasonable enquires of donors to determine correct amount for “eligible gift” in receipt
 - Ensure proper donation receipting
 - Ensure gifts are used for charitable purposes
 - Review and enforce terms of restricted and endowed gifts
- **Notice/attendance at meetings/minutes**
 - Right to notice of board meetings
 - Right to attend board meetings

- **Right to vote**
 - Equal voting rights
 - Must declare conflict of interest
 - Need to record contrary vote
- **Appropriate delegation**
 - Can delegate day to day operations, including officer duties
 - But directors must retain control and require accountability
 - Establish an audit committee for finances and legal liability

- 2. Policies and Procedures in Achieving Due Diligence**
- **Establishing and following policy statements and procedures**
 - Develop policies and procedures for staff, volunteers and board members
 - i.e. Policy statements on sexual abuse, sexual harassment, work place safety, counseling and third party use of facilities of the charity

- **Screening procedure**
 - An appropriate screening process is an important protection against increase in abuse claims
 - Screening involves utilizing appropriate questions, interviews, reference of employees and volunteers, together with police checks when individuals are dealing with children
- **Training/education**
 - Directors should maintain their skills and knowledge in the area of the charity's current operation
 - Directors need to educate themselves about changes in the law affecting directors' duties

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- Directors need to ensure that senior management are also kept adequately informed on current legal issues
- **Utilizing due diligence checklists**
 - Legal Risk Management Checklist
 - Sexual abuse checklist
 - Fundraising compliance due diligence checklist
 - Anti-terrorism due diligence checklist
 - Insurance checklist

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- **Outside professionals**
 - Relying on professional advisors like accountants and lawyers provides evidence of due diligence
 - Reduces exposure to liability
- **Delegation of investment decision making to investment manager requires agency agreement and investment policy under *Trustee Act* (Ontario)**

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E. DUE DILIGENCE IN INDEMNIFICATION AND INSURANCE

1. Statutory Basis for Directors and Officers insurance and Corporate Indemnity

- Federal and Ontario corporate statutes now permit corporate indemnity and director and officer insurance
- But in Ontario, charities must first consider the following under the *Charities Accounting Act* (Ontario)
 - What is the degree of risk?
 - Are there alternatives to insurance?
 - What is the cost of insurance in relation to the risk?

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- What is the cost of insurance in relation to revenue?
- Does indemnity or insurance further the management of charitable property?

2. Corporate Indemnification

- Corporate indemnification provides compensation for the following:
 - Legal fees
 - Fines that were paid under a statute
 - A financial settlement that result from a lawsuit
 - Any other obligation that a director was required to fulfill

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- Corporate indemnification should always be implemented but may be of limited benefit
- Indemnification is only as good as the financial state of the charity

3. Insurance Considerations

- Insurance policies to consider obtaining would include
 - General liability insurance
 - Directors' and officers' insurance
 - Sexual abuse and/or harassment
 - Insurance for particular risks, i.e. counseling, non-owned auto, third-party use of property, etc.

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- **Factors to consider**
 - How much coverage does the policy provide for?
 - Who are the named insured?
 - Does insurance cover all past and present directors, officers and committee members?
 - Is coverage on a “claims made basis” or on an “occurrence basis”?
 - Are there exclusionary clauses that limit the protection offered by the policy, such as sexual abuse?

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- Are there geographical limits to the coverage?
- Insurance will likely not provide coverage for actions by public authorities for breach of trust, improper investments, or violations of the *Anti-terrorism Act* (Canada), Bill C-45 amendments to the *Criminal Code* (Westray Mines) or other similar strict liability legislation
- Advise agent in writing each year of all activities of the charity and all known risks

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- Ask agent/insurance company to respond in writing to the following:
 - What risks are covered?
 - Who is covered under the policy?
 - What is the amount of the coverage?
 - What risks are not covered under the policy?
 - What additional insurance should be obtained by the charity?

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F. OTHER MEANS OF DUE DILIGENCE IN REDUCING RISK

1. Legal Risk Management Committees

- Legal risk management committee need to be formed to conduct review and identify risk
- Need to conduct ongoing review of assets and risks utilize legal risk management checklist

2. Independent Legal Advice

- Independent legal advice needed for directors in high risk situations

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- Directors may need to seek independent legal advice before resigning from the board of directors

3. Size of the Board

- Reducing size of board reduces risk
- Smaller board may also allow for more effective control

4. Committees and Advisory Boards

- Committees and advisory boards can be an effective means of attracting volunteers without the risk of being directors

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- But board of directors must always remain in control

5. Transfer of Assets

- Directors will always be somewhat exposed to liability risks
- Therefore directors should consider transferring personal assets to spouse
- However any transfer of assets must be done before becoming a director so as not to defeat claims of creditors

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Part IV
How to Avoid Liability in Fundraising

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A. OVERVIEW

- Legal Responsibility of Charities and Directors in Fundraising
- Developing a Proactive Risk Management Approach to Fundraising
- Donor’s Rights and Remedies in Fundraising
- Avoiding Liability from Testamentary Charitable Gifts
- Avoiding Liability from Donor Restricted Charitable Gifts
- Avoiding Liability in Gift and Fundraising Programs

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B. RESOURCE MATERIALS

- www.charitylaw.ca
 - Article entitled “Looking a Gift Horse in the Mouth - Avoiding Legal Liability in Fundraising”
 - Article entitled “Donor Restricted Charitable Gifts Revisited: A Practical Overview”
 - Charity Law Bulletins #8, #9, #13, #17, #21, #23, #35 and #72
- www.antiterrorismlaw.ca
 - Article entitled “The Impact of Anti-Terrorism Legislation on Charities: The Shadow of the Law”

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C. LEGAL RESPONSIBILITY OF CHARITIES AND DIRECTORS IN FUNDRAISING

- Improper or negligent actions by development officers or fundraisers may expose a charity and its directors to legal liability
- The court held in *The Aids Society for Children* (Ontario) that
 - Third party fundraisers and subcontractors are agents of the charity and may cause liability for both the charity and its board of directors personally

4

- Fundraising contracts which provide for unreasonable compensation 70% to 80% will be void ab initio based upon both violation of public policy and/or misrepresentation
- Misrepresentation is determined by the perception of the donor, not by the intent of the charity or its directors in receiving the gifts
- The fiduciary duty of a charity and its board of directors to account for donations applies to the gross amount of donations raised by third party fundraisers, not to the net amount that the charity may be entitled to pursuant to a fundraising contract

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- The directors were found personally liable for unreasonable fundraising costs in the amount of \$766,000
- Fundraising companies were required to repay unreasonable fundraising costs
- The directors were subjected to a penalty of \$50,000.00 under the *Charities Accounting Act* (Ontario)
- The court in *National Society for Abused Women and Children* confirmed
 - Fiduciary obligation of directors to account for unconscionable fundraising costs
 - Fundraising contract was declared void ab initio as being contrary to public policy

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- Donors are entitled to know about fundraising and administrative costs when making donations
- For more information on these cases, see Charity Law Bulletins #9, #13 and #17 at www.charitylaw.ca
- PGT recently obtained a restraining order against a Nova Scotia charity operating in Ontario involving 78% fundraising costs (Canadian’s against *Child Abuse Society*)
- The “buck” stops with the board of directors of a charity after everyone else has left the charity
- The board of directors must therefore be made familiar with all fundraising programs and the liabilities that are associated with those programs

- D. DEVELOPING A PROACTIVE RISK MANAGEMENT APPROACH TO FUNDRAISING**
- Legal liability in fundraising can be reduced by developing a proactive legal risk management approach to fundraising
 - Fundraising must comply with the applicable corporate objects and powers of the charity
 - The fundraising program must not be *ultra vires* the charitable objects of the charity
 - The charitable purpose being furthered by fundraising must not be *ultra vires* the charitable objects
 - A donor restricted gift resulting from fundraising must not be *ultra vires* the charitable objects

- Fundraising must not violate applicable statutory provisions
 - Selected specific charitable statutes affecting fundraising
 - *Charities Accounting Act* (Ontario)
 - *Charitable Gifts Act* (Ontario)
 - *Religious Organizations Land Act* (Ontario)
 - *Income Tax Act* (Canada)
 - *Charitable Fund-raising Act* (Alberta)

- *The Charities Endorsement Act* (Manitoba)
- *Charities Act* (PEI)
- *Charitable Fund-raising Businesses Act* (Saskatchewan)
- *Anti-terrorism Act* (Canada)
- *Taxation Act* (Quebec)
- Uniform Law Reform Conference has released draft uniform fundraising legislation see website www.ulcc.ca/en/home
- Fundraising must not involve gifts that are contrary to public policy
 - Charitable gifts involving discrimination
 - Charitable gifts involving illegal activities

- The impact of 2001 regulations under the *Charities Accounting Act* (Ontario) for commingling
 - No relief to the common law rule prohibiting directors from receiving remuneration
 - Indemnification of directors and officers and liability insurance is now permitted under prescribed circumstances
 - Charities may commingle restricted and special purpose funds provided that prescribed accounting records are maintained
 - However, the *Public Guardian and Trustee* of Ontario does not permit commingling of restricted funds and general funds

- E. DONOR'S RIGHTS AND REMEDIES IN FUNDRAISING**
- General exposure to liability involving donors
 - Misrepresentation involving issuance of charitable receipts and/or the amount
 - Failure to comply with donor restrictions
 - Failure to disclose excessive fundraising costs
 - Detrimental reliance upon charitable endorsements
 - Detrimental reliance upon improper tax advice involving donations
 - Breach of fiduciary duty and/or breach of trust in applying funds to charitable purposes

- Donor's statutory rights
 - *Charities Accounting Act (Ontario)*
 - Section 6 of the CAA (public inquiry)
 - Section 10 of the CAA (alleged breach of trust)
 - Section 4(d) of the CAA (noncompliance with donor directions)
 - Section 3 of the CAA (formal passing of accounts)
 - The *Income Tax Act (Canada)*
 - Informal complaint to CRA
 - Resulting audits
 - Receiving and disbursement violations

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F. AVOIDING LIABILITY FROM TESTAMENTARY CHARITABLE GIFTS

- Reducing legal risks from estate planning programs
 - Shift the legal risk away from the charity
 - Download the risk to professionals, i.e. accountants or lawyers, to establish evidence of due diligence
 - Raise the shield of liability insurance whenever possible, if available
 - Return any original wills or codicils to donors or their lawyers

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- Avoid circumstances conducive to allegations of undue influence
 - Directing work to a particular lawyer
 - Paying for a portion of donor's legal costs
 - Acting as either an estate trustee (executor) or attorney under a power of attorney
 - Preparing a will or power of attorney
 - Providing advice on how to structure disposition clauses in a will
 - Providing recommendations on how much of the estate should be given to a charity or charities in general

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- **Completing the will guide on behalf of the testator instead of only assisting with background information**
- **Meeting with the lawyer when the donor gives instructions for the will**
- **Being present when the will is being signed**
- **Offering to store the original will, codicil to a will, or power of attorney**
- **Managing testamentary gifts**
 - **Ensure that a copy of the will is received and carefully review charitable gift provisions**
 - **Review any applicable donor restrictions before agreeing to receive the gift**

- **Require progress reports on the administration of an estate**
- **Request the distribution of gifts to the estate at the earliest opportunity**
- **Have legal counsel review estate releases as the charity cannot sign an indemnity for money or cause of action beyond what the estate would have otherwise been liable for**
- **Have legal counsel review estate accounts before signing estate releases**
- **Review appropriateness of investments**
- **Ensure that tax credits are used against 100% of income in the year of death and carried back one year, if applicable**

- **Make sure that only duly authorized signing officers execute the releases**
- **Resist voluntarily renouncement of a gift**
 - **A charity may be asked to renounce a testamentary gift in situations of financial hardship involving family members of the deceased**
 - **There is no legal authority for a charity to unilaterally renounce a gift**
 - **Even court authorization for a renunciation of a testamentary gift is unlikely**
 - **The charity therefore has a fiduciary obligation to pursue testamentary gifts**
- **Ensure that testamentary gifts continue to honour outstanding pledges**

G. AVOIDING LIABILITY FROM DONOR RESTRICTED CHARITABLE GIFTS

- **The difference between unrestricted and donor restricted charitable gifts**
 - **What is an unrestricted charitable gift?**
 - **An unrestricted charitable gift is a gift to the charity that is not subject to any restrictions or limitations**
 - **What is a donor restricted charitable gift?**
 - **A donor restricted charitable gift that is a gift subject to binding restrictions, conditions or limitations**

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- **Instances of breach of trust involving donor restricted charitable gifts**
 - **Diverting a fund to another application**
 - **Withholding a fund**
 - **Pooling restricted funds with funds of another donor**
 - **Encroaching on the capital of an endowment fund**
 - **Altering the terms of a trust deed**
 - **Borrowing from a restricted fund**
 - **Using surplus funds from a fundraising appeal for a different purpose**

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- **Altering terms of a donor restricted fund without court authorization**
- **Can a donor restriction be unilaterally varied?**
 - **Only a court can vary a donor restricted charitable gift on a *cyprés* application**
 - **Exceptions are**
 - **Gift reverting to the donor on a failed *cyprés* application**
 - **Gift reverting to the donor on the failure of either a condition precedent or a condition subsequent**

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- **How should donor restricted gifts be managed once received?**
 - Identify the nature of the charitable gift
 - Review and approve donor restrictions
 - Effective ongoing management of donor restricted charitable gifts
 - Deposit into the bank account of the named charity
 - Invest fund in accordance with applicable investment power
 - Do not borrow against restricted fund
 - Commingle restricted funds only in accordance with regulations in Ontario and not with general funds

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- Effective ongoing management of donor restricted charitable gifts
 - Deposit into the bank account of the named charity
 - Invest fund in accordance with applicable investment power
 - Do not borrow against restricted fund
 - Commingle restricted funds only in accordance with regulations in Ontario and not with general funds

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- **How can donor restricted charitable gifts be avoided in the first instance?**
 - Encourage unrestricted gifts
 - Alternatively encourage the use of non-binding directions
 - Advise donors that all gifts are deemed to be unrestricted unless specifically stated otherwise

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- Preventative steps to reduce liability involving donor restricted charitable gifts
 - Public fundraising appeals should state that any surplus funds will be used for the general charitable purposes of the charity
 - Ensure that donor restricted gift includes a *cyprés* clause that will allow the charity to amend the purpose
 - Ensure that documentation creating donor restricted charitable trusts include the words “in trust”

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- Protecting donor restricted charitable gifts
 - Impact of the Christian Brothers Ont. Court of Appeal decision
 - Claims against charities may increase
 - Special purpose trust endowments will be at risk to creditors of the charity
 - The ability of donors to create enforceable restricted gifts will be weakened
 - Donors will be reluctant to give large gifts directly to an operating charity

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- Developing a strategy in response
 - Utilize an arms length parallel foundation
 - Utilize a community foundation or trust company
 - Structure gift as a determinative gift with a gift over to another charity
 - For more information see www.charitylaw.ca article on “*Donor Restricted Charitable Gifts Revisited: A Practical Overview*”
- Proposed legislation in B.C. (Bill 63) to protect special purpose charities trusts

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- Comparison to conditional gifts
 - What is the nature of a conditional gift?
 - A conditional gift involves the charity becoming the beneficial owner of the gift subject to being defeated by a condition
 - With a special purpose charitable trust, the charity never becomes the beneficial owner of the gift but instead holds it in trust
 - Receipting conditional gifts
 - Condition precedent gifts cannot be receipted
 - Condition subsequent gifts may be receiptable:
 - Reversion to donor precludes receipting
 - Reversion to another charity can likely be receipted

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- H. AVOIDING LIABILITY IN GIFT AND FUNDRAISING PROGRAMS**
- Gifts of Shares
 - Gift of shares or interests in a business will be subjected to the *Charitable Gifts Act* (Ontario)
 - Charities can not own more than a 10% interest in a business for longer than 7 years
 - If a charity owns more than a 50% interest in a business then reporting requirements to P.G.T. apply
 - Potential liability in relation to improper valuing and receipting of shares of publicly traded companies

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- Need to review CRA position on determining fair market value
- Need to review factors outlined by CRA in valuing shares as set out in Registered Charity Newsletter No. 12
- Gifts of real estate
 - Three year restriction on leasing property under the *Charities Accounting Act* (Ontario)
 - Forty year restriction on leasing property under the *Religious Organization Land Act*
 - Liability for toxic property and need for environmental assessment
 - Need for due diligence searches
 - Inability of charity to manage real property

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- Receiving used “gifts in kind”
 - Need for appraised fair market value
 - Potential liability to third parties from using recycled property
- Self insured gift annuities
 - The difference between self insured and reinsured gift annuities
 - Self insured gift annuity
 - Reinsured gift annuity
 - Legal risks associated with self insured annuities
 - Lack of corporate authority

- Possible violation of the *Insurance Act (Ont)*
- Operational financial risks
- Restrictions on foundations issuing annuities
- Debt instruments forgivable on death
 - Need testamentary instrument to forgive debt
 - If not properly forgiven, will become an asset owing to the estate
- Bill C-45 Amendments to the Criminal Code (Westray Mines)
 - In effect criminalizes situations which previously were only matters of negligence

- Charities, directors and officers may be exposed to personal liability
- insurance may not be available for defence costs
- See Charity Law Bulletin #35 and #72 at www.charitylaw.ca for more details
- Transferring capital funds between charities
 - Ensure that there are charitable objects to permit the transfer of funds
 - Identify donor restricted charitable gifts
 - Identify impossible or impractical donor restrictions
 - Change of trustees by deed of trust
 - Unrestricted funds to be applied for original charitable purpose

- Investment issues in fundraising
 - Determine which investment powers apply and in what jurisdiction
 - Adapt and implement an investment plan
 - Investment plan needs to comply with *Trustee Act* (Ontario) particularly for delegation
 - Investment plan needs to incorporate and override the investment plan and/or agency agreement of an investment manager
 - See www.charitylaw.ca, Charity Law Bulletin #8 and “Looking a Gift Horse in the Mouth Avoiding Liability in Charitable Fundraising” article for more information

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- Managed or pooled investment of charitable funds
 - Does the recipient charity have the corporate power to operate a pooled fund?
 - Does the investment power of each participating charity permit it to invest charitable monies by pooling monies with a third party?
 - Does the *Loan and Trust Corporations Act* (Ontario) have application?
 - Does the *Securities Act* (Ontario) have application?
 - Is court authorization required to pool investment funds of various charities?

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- Federal *Competition Act* - Deceptive telemarketing & false or misleading misrepresentation
 - Definition of “business” includes the raising of funds for charitable or other non-profit purposes
 - The *Competition Act* does not apply to fundraising that is solely charitable in purpose
 - However, if the part of the purpose of the fundraising includes promoting products or services, the *Competition Act* may apply
 - Telemarketing is prohibited unless there is statutorily mandated disclosure
 - Violation of the *Competitions Act* constitutes a criminal offence

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- A due diligence defence is available
- Directors and officers of a charity can be held personally liable
- The prohibition on false or misleading representation applies to telemarketing, door-to-door solicitation, and items offered for sale by the charity
- A false or misleading representation does not require that it be proven that any person was deceived or misled
- CRTC pending changes to rules for fundraising
 - Affects charities that make their own telemarketing calls in-house, as well as third-party, for-profit telemarketing firms engaged by charities

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- On September 28, 2004, the CRTC suspended the application of the new telemarketing rules from May 2004 decision
- Decision is now under review as a result of the Canadian Marketing Association's application to review and vary that decision
- The requirement that telecommunications service providers track and report complaint statistics is still valid, effective January 1, 2005

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- Bill C-37, an Act to amend the *Telecommunications Act*
 - Royal assent given November 25, 2005 (Act not yet in force)
 - Enables the CRTC to establish a national do not call list
 - Establishes an administrative monetary penalty for the contravention of the do not call list (\$1,500 for individuals; \$15,000 for corporations)
 - Under s.41.7, registered charities are exempted from prohibition orders against unsolicited telecommunications
 - CRTC should now proceed to public consultations to work out details of the do not call list

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- Legal issues involving fundraising on the internet
 - Territorial jurisdictional issues
 - Intellectual property law issues
 - Potential for civil action from the internet
 - Domain names, trade-marks and the internet
 - Marketing and advertising on the internet
 - PIPEDA and provincial privacy legislation

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- Legal issues in sponsorship arrangements
 - Distinguishing between receiptable donations and non-receiptable sponsorship payments
 - The importance of documenting sponsorship arrangements
 - Protecting and licensing trade-marks in sponsorship arrangements
 - Liability exposure from sponsorship arrangements

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- Fundraising Liability and Anti-terrorism
 - Anti-terrorism Legislation is very complicated, see www.antiterrorism.ca for article “Charities and Compliance with Anti-terrorism Legislation: The Shadow of the Law”
 - Charity and its directors need to have a working knowledge of the anti-terrorism legislation in making a gift to charity

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- **Anti-terrorism legislation is currently under review by the Federal Government**
- **Anti-terrorism legislation will have serious impact on charities and their board of directors**
- **Charities that carry on international operations will also need to be aware of the impact of anti-terrorism legislation in other jurisdictions**

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- **Criminal Code provisions**
 - **Broad and vague definitions of “Terrorist Activities” and “Terrorist Group”**
 - **Mens rea may be an issue**
 - **May have the effect of catching legitimate humanitarian charities**
- **Loss of charitable status through minister’s certificate**
 - **Ministers can issue certificate if minister has reasonable grounds to believe that an organization is supporting terrorist activities**

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- **Certificate is referred to federal court judge**
- **Federal court may hear evidence in private**
- **Information considered may include information from foreign governments and organizations**
- **Rules of evidence do not apply**
- **Certificate in effect for 7 years**

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– Anti money laundering legislation

- May apply to charities in future regulations
- May apply to charities immediately because of statutory authority of charities to issue securities under the *Securities Act*
- Large or cross-border donations may result in mandatory reporting to FINTRAC

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– Inherent problems

- Lack of procedural fairness
- No due diligence defence
- Discriminating to ethnic and religious charities
- Negative effect upon public perception
- Severe criminal code penalties
- Vicarious liability for international operations through agency arrangement
- Breach of fiduciary duty by director
- Concerns about lack of insurance coverage

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– Due diligence response

- Need to become familiar with specifics of anti-terrorism legislation
- Need to establish due diligence policy to comply with the law
- Need to conduct due diligence review of directors, officers and key individuals
- Monitor how monies are being raised and disbursed
- Review and monitor international relationships, i.e. agency agreement and joint venture
- Need release and indemnities from third parties

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**INSTITUTE OF CHARTERED ACCOUNTANTS
OF ONTARIO**

**RECENT CHANGES TO THE *INCOME TAX ACT*
AFFECTING CHARITIES**

Toronto – December 6, 2005

- 1. New Disbursement Quota Rules**
 - 2. Proposed New Split-Receipting Rules,
Reasonable Enquiry and Private
Foundations**
 - 3. Audits and New Interim Sanctions/
Penalties for Charities**
 - 4. Returning a Gift – What are the Options?**
-

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INSTITUTE OF CHARTERED
ACCOUNTANTS OF ONTARIO
**RECENT CHANGES TO THE *INCOME*
TAX ACT AFFECTING CHARITIES**
Toronto – December 6, 2005

New Disbursement Quota Rules

By Terrance S. Carter, B.A., LL.B.
and Theresa L.M. Man, B.Sc., M.Mus., LL.B.
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RESOURCE MATERIALS

- This power point presentation consists of excerpts from:
- A paper entitled “New Disbursement Quota Rules Under Bill C-33” dated May 6, 2005
- Charity Law Bulletins #54, #55, #56, #59, #67, #69 and #80

all available at www.charitylaw.ca

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KEY POINTS TO REMEMBER

- The 4.5% disbursement quota is reduced to 3.5%
- The 3.5% disbursement quota is extended to charitable organizations
- Inter-charity transfers to charitable organizations are now subject to the 80% disbursement quota
- The 80% disbursement quota can be delayed through utilizing “enduring property” including ten year gifts
- Inter-charity transfers have become more complicated

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**LEGISLATION IMPLEMENTING
REGULATORY REFORM AND
DISBURSEMENT QUOTAS:**

- **March 23, 2004 - Federal Budget**
- **September 16, 2004 - Draft Legislation**
- **December 6, 2004 - Ways and Means Motion - Bill C-33 from March 2004 Federal Budget**
- **May 13, 2005 - Passage of Bill C-33 (May 2005 Amendments)**

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INTRODUCTION

- **What is the Disbursement Quota? (“DQ”)**
 - **A prescribed amount that registered charities must disburse each year in order to maintain their charitable registration**
 - **80/20 for receipted gifts**
 - **3.5% (formerly 4.5%) for non-charitable assets**
- **Purpose of DQ**
 - **To ensure charities use charitable funds on charitable/activities**
 - **To discourage charities from spending excessive amounts on fundraising and from accumulating excessive funds**

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- **Importance of DQ**
 - **For charities, donors, advisors**
 - **Inter-charity transfers**
 - **Nature of property gifted**
 - **Nature of restrictions imposed**
 - **Source of the gift**
 - **Nature of the proposed recipient charity**

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- **History of DQ Formula Changes**
 - **Prior to Bill C-33:**
 $A + A.1 + B + \{C \times 0.045 [D - (E + F)]\} \div 365 + G$
 - **September 2004 Proposed:**
 $A + A.1 + A.2 + B + \{C \times 0.035 [D - (E + F)]\} \div 365$
 - **December 2004 / Bill C-33:**
 $A + A.1 + B + B.1$
 $B.1 = C \times 0.035 [D - (E + F)] \div 365$

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DQ RULES PRIOR TO THE PROPOSED AMENDMENTS

Charitable organizations

- **80% of received donations in preceding year, except:**
 - i. gifts of capital received as bequest or inheritance
 - ii. ten-year gifts
 - iii. gifts received from other registered charities
- **80% of amounts previously excluded under (i) and (ii) but which are spent in the year**

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Public and Private Foundations

- **80% of received donations in preceding year, except:**
 - i. gifts of capital received as bequest or inheritance
 - ii. ten-year gifts
- **80% of amounts previously excluded under (i) and (ii) but which are spent in the year**
- **80% of gifts received from other charities, other than specified gifts (100% for private foundations)**
- **4.5% of average value of investment property**

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NEW DQ FORMULA A + A.1 + B + B.1

- A = 80% of prior year received donations (excluding enduring property and gifts from other charities)
- A.1 = amount by which
 - a) sum of
 - (i) 80% enduring property expended in year (except for specified gift, pre-1994 bequests or inheritances and property described in (ii) plus
 - (ii) total enduring property gifts transferred to qualified donees (except specified gift)
 - Exceeds
 - b) amount claimed by charity that may not exceed lesser of 3.5% of investment assets and capital gains pool for year

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- B = 100% of gifts from other charities if private foundation and 80% if charitable organization or public foundation (except specified gifts and enduring property)
- $B.1 = \frac{C \times .035 [D - (E + F)]}{365}$
- (3.5% of capital is the "D" amount, and D must be greater than \$25,000)
- See accompanying colour DQ Chart in Charity Law Bulletin #67 for more details

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REDUCTION OF DQ RATE

- Public and private foundations had been subject to a 4.5% DQ on capital assets not used in charitable activities or administration
- 4.5% DQ reduced to 3.5%
- Based on the current real rate of return minus 20% attributable to administrative costs
- More representative of historical long-term real rates of return earned
- Rate to be reviewed periodically
- Applies to taxation years that begin after March 22, 2004

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EXTENSION OF 3.5% DQ TO CHARITABLE ORGANIZATIONS

- Only public and private foundations had been subject to the 4.5% DQ
- The reduced 3.5% DQ will now apply to charitable organizations as well
- Because charitable organizations can also hold capital endowments from which investment income is generated
- For charitable organizations registered after March 22, 2004, the 3.5% DQ will apply to their taxation years that begin after March 22, 2004
- For charitable organizations registered before March 23, 2004, the 3.5% DQ will apply to their taxation years that begin after 2008
- Removes a key difference between charitable organizations and foundations

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DE MINIMUS THRESHOLD ON THE APPLICATION OF THE 3.5% DQ

- 3.5 % DQ only applies to registered charities if they hold investment assets greater than \$25,000
- To provide relief to small charities, although it is considered generally too low for an effective threshold

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NEW CONCEPT OF “ENDURING PROPERTY”

- New term “enduring property” includes 4 types of property
 - Gifts by way of bequest or inheritance
 - Inter-charity gifts received by an arm’s length charitable organization to be expended in the next 5 years or less on its charitable activities
 - Ten-year gifts
 - Inter-charity transfer of ten-year gifts and gifts by way of bequest or inheritance

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1. Gifts by way of bequest or inheritance

- Where an individual has designated a charity as a direct beneficiary of an RRSP, RRIF or life insurance policy, the May 2005 amendments 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 in the year in which they are disbursed

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- ‘Applies in respect of deaths after 1998, which retroactivity may lead to hardship for charities that relied on the earlier position of CRA that such direct designations would not be included in the charities’ DQ from 2000 to the present
- These gifts will no longer be limited to “gifts of capital received by way of bequests or inheritance”, therefore a testamentary income interest received by a charity would be included

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2. Inter-charity gifts received by a charitable organization to be expended in the next 5 years or less in its charitable activities

- Gift received by a charitable organization from another registered charity
- More than 50% of the directors of the donor deal at arm’s length with each director of the donee charitable organization

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- The gift must be subject to a trust or direction requiring that the gift be utilized over a period not exceeding five years
 - (i) in the course of a program of charitable activities that could not reasonably be completed in the first year
 - (ii) for the purpose of acquiring a capital property of the charitable organization to be used directly in its charitable activities or administration

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3. Ten-year gifts

- A gift from a donor to a registered charity subject to a trust or a direction that the gift is to be held for a at least ten years
- A ten year gift now permits the original recipient charity or a transferee charity to expend the realized capital gains from the ten year gift before the end of 10 years as described below

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4. Inter-charity transfer of ten-year gifts and gifts by way of bequest or inheritance

- Gifts by way of bequest or inheritance and ten-year gifts (but not 5-year gifts) from either an original recipient charity or another transferee charity
- Provided that if the gift is a ten-year gift, the gift is subject to the same terms and conditions under the trust or direction

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ENCROACHMENT ON ENDURING PROPERTY

- New concept introduced of a “capital gains pool”, which is a notional account to keep track of the amount of capital gains realized by a charity from the disposition of “enduring property”
- Charities are now able to encroach on the capital gains from enduring property, provided that the terms of the gift permit such encroachment, but only up to the lesser of the amount of the 3.5% disbursement quota and the amount in the “capital gains pool”

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- Charities will need to decide how much to claim within the permitted encroachment limit of the capital gains pool
- Charities should track their capital gains pool each year on their T3010A
- Anything above the permitted encroachment limit will be added back into the 80% disbursement quota for the charity and therefore will have limited benefit in meeting the 3.5% disbursement quota
- The combination of the yearly tracking requirement for the “capital gains pool” and the determination of what is a capital gain will make the calculation of the disbursement quota challenging for charities to comply with

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INTER-CHARITY TRANSFERS

1. Gifts transferred to charitable organizations
 - Previously, only transfers from registered charities to public and private foundations are subject to the 80% DQ
 - i.e. transfers from registered charities to charitable organizations are exempt from the 80% DQ
 - Now, all transfers of funds from one registered charity to another, including transfers to a charitable organization (but excluding transfers of enduring property) will be subject to the 80% disbursement obligation, i.e. 80% of the gift must be expended in the following taxation year
 - Exception for a “specified gift” will continue to apply

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- Apply to transfers received by charitable organizations in taxation years that begin after March 22, 2004
- 2. Three categories of property transfers
 - Ordinary gifts (i.e. not specified gifts, not enduring property)
 - Specified gifts
 - Enduring property that has not been designated as specified gifts by the transferor charity

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Transfer of ordinary gifts

- i.e., neither specified gifts, nor enduring property
- For the transferor charity, the transfer can be used to satisfy its DQ obligation
- For the transferee charity, there will be an obligation to expend the gift in the following year (because of variable B in DQ formula)
- If the transferee charity is either a charitable organization or a public foundation, the DQ obligation is 80% of the gift

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- If the transferee charity is a private foundation, the DQ obligation is 100% of the gift
- For example: \$100 ordinary gift transferred from Charity A to Charity B

	Transferor Charity A		Transferee Charity B	
	DQ obligation	DQ satisfaction	DQ obligation	DQ satisfaction
Year 1	N/A	\$100 expended can be used to satisfy its DQ obligations of Charity A in year 1	<ul style="list-style-type: none"> •Charitable organizations and public foundations have to expend \$80 in year 2 •Private foundations have to expend \$100 in year 2 	N/A

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- When Charity B expends the ordinary gift in the following year, Charity B can use the expenditure to satisfy its DQ obligation in year 2 mentioned above

	Transferee Charity B	
	DQ obligation	DQ satisfaction
Year 2	N/A	The \$ expended can be used to satisfy DQ obligation in year 2

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Transfer of specified gifts

- For the transferor charity, the transfer cannot be used to satisfy its DQ obligation
- For the transferee charity, there is no obligation to expend the specified gift in the following year

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- For example: \$100 specified gift transferred from Charity A to Charity B

	Transferor Charity A		Transferee Charity B	
	DQ obligation	DQ satisfaction	DQ obligation	DQ satisfaction
Year 1	N/A	--- Charity A cannot use the \$100 to satisfy its DQ obligation in year 1	--- Charity B is not obligated to expend any of the \$100 in year 2	N/A

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- When Charity B expends the specified gift in a subsequent year, Charity B can use the expenditure to satisfy its DQ obligations in that year

	Transferee Charity B	
	DQ obligation	DQ satisfaction
Subsequent Year	N/A	\$100 expended can be used to satisfy DQ obligations in that year

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Transfer of enduring property

- The following rules do not apply to enduring property received as specified gifts
- For the transferor charity, there will be a DQ obligation to expend the enduring property in the year
- The DQ obligation is met by the transfer itself
- For the transferee charity, there is no obligation to expend the enduring property in the following year
- For example: \$100 enduring property transferred from Charity A to Charity B

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	Transferor Charity A		Transferee Charity B	
	DQ obligation	DQ satisfaction	DQ obligation	DQ satisfaction
Year 1	Charity A will be obligated to expend 100% of the fmv of the enduring property in year 1	The DQ obligation created by the transfer is met by the transfer itself	--- no effect on DQ (b/c enduring property is exempt from B in DQ formula)	--- no effect on DQ until Charity B expends the gift

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- When Charity B expends the enduring property in a subsequent year, Charity B will be obligated to expend at least 80% of the enduring property
- The DQ obligation for that year would be met by the expenditure of the enduring property

	Transferee Charity B	
	DQ obligation	DQ satisfaction
Subsequent Year	Charity B will be obligated to expend at least 80% in the year	The \$ expended can be used to satisfy DQ obligation in the year

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- However, if Charity A designates the enduring property as a specified gift, then Charity A would not be able to use the expenditure to satisfy its DQ obligation in the year of transfer
- Charity B would receive the enduring property as a specified gift, which would not create any DQ obligation to expend the specified gift
- When Charity B expends the gift in a subsequent year, Charity B would be able to use the expenditure to satisfy its other DQ obligations in that year
- Limited reasons for the transferor charity to agree to transfer the enduring property as a specified gift

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	Transferor Charity A		Transferee Charity B	
	DQ obligation	DQ satisfaction	DQ obligation	DQ satisfaction
Year 1	Charity A will be obligated to expend \$100 in year 1	Charity A cannot use the \$100 to satisfy its DQ obligation in year 1	Charity B is not obligated to expend any of the \$100 in the following year	N/A
Subsequent Year	N/A	N/A	N/A	\$100 expended can be used to satisfy other DQ obligations in that year

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Transfer as a result of penalty

- A transfer to another registered charity under Part V does not qualify as an expenditure for the purposes of calculating the transferor's DQ
- Applies in respect of notices of intention to revoke the registration of a charity and to notices of assessment issued by the Minister after the day that is 30 days after Royal Assent

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CONCLUSION

- Attempt by the Department of Finance to address a number of problems facing charities involving DQ
- Very complex new DQ rules - difficult, if not impossible, for the average charity to understand, let alone comply with
- Concerns about removing key differences between charitable organizations and public foundations

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INSTITUTE OF CHARTERED
ACCOUNTANTS OF ONTARIO
**RECENT CHANGES TO THE *INCOME TAX*
ACT AFFECTING CHARITIES**
Toronto – December 6, 2005

**Proposed New Split-Receipting Rules,
Reasonable Enquiry and Private Foundations**

By Terrance S. Carter, B.A., LL.B.
and Theresa L.M. Man, B.Sc., M.Mus., LL.B.
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RESOURCE MATERIALS

This power point presentation consists of excerpts from:

- A paper entitled “Recent Changes to the *Income Tax Act* Affecting Charities and Gift Planning” dated March 16, 2005
- Charity Law Bulletins #76, #77 and #80 all available at www.charitylaw.ca

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**SUMMARY OF JULY/2005 PROPOSED
AMENDMENTS**

- A gift will permit some consideration to be received by the donor
- New split receipting rules will apply
- New broader definition of “advantage” may reduce the amount of a charitable receipt
- New broader definition of a charitable organization and public foundation will apply

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- **Complicated new rules to curtail tax shelter schemes may result in reduction of charitable receipts for gifts in kind**
- **Charities will need to make reasonable inquiries of donors for all gifts, whether gifts in kind or cash**
- **New expanded basis for revocation of a charity will apply**
- **Different proposed changes have different effective dates, some are retroactive**

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- HISTORY OF THE JULY 2005 PROPOSED AMENDMENTS :**
- **December 20, 2002 - Draft Amendments**
 - **December 24, 2002 - Income Tax Technical News No. 26**
 - **February 28, 2003 - Federal Budget**
 - **December 5, 2003 - Draft Amendments**
 - **February 27, 2004 - Revised Draft Technical Amendments**
 - **July 18, 2005 Special Release – Legislative Proposals Relating to Income Tax**

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- HIGHLIGHTS OF THE JULY 2005 PROPOSED AMENDMENTS**
- 1. Meaning 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; and**
 - **no consideration or advantage can be received by the donor**

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- July 2005 draft amendments to the *Income Tax Act* create a new concept of “gift” for tax purposes which permits a donor to receive benefit, provided that the value of the property donated exceeds the benefit received by the donor
- Concept is commonly referred to as “split-receipting”

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- The July 2005 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 transfer

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2. New Split Receipting Rules:

- Charitable donation receipts must now reflect the following formula:

$$\begin{array}{rcl} \text{Eligible Amount} & = & \text{Fair Market} \\ \text{of Gift} & & \text{Value of the} \\ & & \text{Property} \\ & & \text{Donated} \end{array} \quad - \quad \begin{array}{l} \text{Advantage} \\ \text{Received by} \\ \text{Donor} \end{array}$$

- (1) Must be voluntary transfer of property with a clearly ascertainable value

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(2) Donative intent required

- **Must have a clear donative intent by the donor to benefit the charity**
- **Donative intent will generally be presumed if the fair market value of the advantage does not exceed 80% of the value of the gift**

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(3) Advantage

- **Broad definition - includes:**
 - **the total value of all property, services, compensation, use 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 receive (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**

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- **The advantage must be clearly identified and its value ascertainable**
- **Value of advantage is the total value of any “property, service, compensation, use or other benefit” in question**
- **Timing of valuation is the time when the gift is made**
- **The advantage can be received prior to, at the same time as, or subsequent to the making of the gift**
- **Does not require a causal relationship between the making of the gift and the receiving of the advantage, as long as the advantage is related to the gift**

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- The advantage can be provided to the donor or to a person or partnership not dealing at arm's length with the donor
- It is not necessary that the advantage be received from the charity that received the gift, i.e. the advantage could be provided by third parties unbeknownst to the charity, which fact will necessitate that charities make inquiries of donors to determine if they have received a related benefit from anyone
- CRA's administrative exemption applies where there is a token advantage of the lesser of 10% of the value of the gift and \$75 (*de minimis* threshold)

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(4) The "deemed fair market value" rules arising from donation tax shelter schemes

- The proposed "deemed fair market value" rules for a gift are the result of the government's attempt to curtail abusive tax shelter donation schemes by severely restricting the tax benefits from donations made under these schemes

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- These donation programs usually involve the item in question being purchased at a substantially lower price than its purported much higher fair market value, and that a donation receipt being issued by a registered charity for the fair market value when the item is donated
- The proposed amendments also curtail the use of limited recourse debt, which 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

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(5)Details of the “deemed fair market value” rules

- Valuation of fair market value (FMV) of donated property
- FMV of donated property will be deemed to be the lesser of
 - the fair market value of the property and
 - 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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- (i) If the donor acquired the property through a “gifting arrangement” i.e. a donation tax shelter scheme
- (ii) If the donor acquired the property less than 3 years before making the gift
- (iii) If the donor acquired the property less than 10 years before making the gift, if it was reasonable to conclude that when the donor acquired the property one of the main reasons for the acquisition was to make a gift (donor must prove that the donor did not have an expectation to make a gift when the property was acquired)

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- New provision also requires a “look-back” to see if the property had been acquired within the 3 or 10 years by a non arm’s length person and if so then the “deemed fair market value” applies to the person
- The deeming provision does not apply to inventory, real property or an immovable situated in Canada, certified cultural property, publicly traded shares and ecological gifts

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- **The deeming provision also does not apply**
 - where the gift is made as a consequence of the donor’s death
 - a shareholder has transferred property to a controlled corporation in exchange for shares and the shares are donated, or a rollover transaction to a corporation for the same purpose of donating shares

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- **New rules to prevent a donor from avoiding 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 (“substantive gifts”)**
- **The new deeming provision is also subject to anti-avoidance rules**

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3. New Reasonable Inquiry Requirement

- **The Proposed Rule: Charities issuing a receipt with an eligible amount in excess of \$5,000 would be required to make “reasonable inquiry” of the donor**
- **Finance announced on November 22, 2005 that it is intending to repeal the above statutory requirement, but such repeal will have little practical implication, since a charity still has an obligation for due diligence purposes to determine the correct amount for the eligible amount of a receipt**

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(a) What is involved?

- The charity must make reasonable inquiry
- The donor must provide the requested information to the charity
- The information on the receipt must be accurate and reflects the fmv (or deemed fmv where applicable) of the donated property, the advantage and the eligible amount of the gift

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(b) When to ask?

- The reasonable inquiry must be made *before* issuing the receipt, not afterwards
- Reasonable inquiry must be made regardless of the type of donated property, including cash and gifts in kind
- Reasonable inquiry must be made whether or not the donor is forthcoming with information

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(c) What to ask?

- What is the due diligence required to determine what is reasonable?
- Must inquire as to the existence of any circumstances in respect of which the new split-receipting or tax shelter rules might apply to cause the eligible amount to be less than the perceived fair market value of the property or cash donated

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- Very broad, includes
 - When was the property acquired?
 - What was the cost of acquisition?
 - Does the donor have any obligation in relation to any limited recourse debt in making the gift?
 - Was the donated property acquired through a donation tax shelter gifting arrangement?
 - Was the property acquired in the last 3 years, if so, what is the donor's cost amount?

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- Was the property acquired in the last 10 years where the donor had an expectation to make a gift at the time when the donor acquired the property , if so, what is the donor's cost amount?
- Did any non arm's length person acquired the property in the past 3 or 10 years prior to making the gift?
- Was there any advantage related to the gift?
- What was the value of the advantage?

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- (d)How to comply with the obligation to make reasonable inquiry?
- Understand what is "reasonable"
 - Understand the split-receipting rules and what information is required, e.g.
 - A charity has to understand what is a "donation tax shelter gifting arrangement" in order to ask the donor whether the donated property was acquired through such an arrangement

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- A charity has to understand what “arm’s length” means in order to ask the donor whether any non arm’s length person acquired the property in the past 3 or 10 years prior to making the gift
- A charity has to understand what would constitute an “advantage” in order to ask the donor whether there was any advantage related to the gift

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- Develop and use questionnaires and due diligence checklists
- Request written confirmation from the donors (signed? sworn?)
- Develop gift acceptance policies
- Ensure detailed documentation in gift agreements
- Issue donation receipts for each gift received, where possible, rather than issuing one receipt at the end of the year for all gifts received

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- Ensure staff of the charity is aware of the split-receipting rules, e.g.
 - Accounting staff because they receive gifts and issue receipts
 - Fundraising and gift planning staff because they contact donors to solicit donations
 - Public relation, marketing and publication staff who prepare fundraising and other promotional materials that makes representation to donors

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(e) What happens if the donor fails to give information to the charity?

- If a donor fails to provide any required information, whether or not the charity has made reasonable inquiries, the eligible amount of the receipt will be deemed to be nil, i.e. no credit or deduction in respect of the gift

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(f) What happens if the Charity fails to ask questions?

- If a charity fails to make reasonable inquiry, this will likely result in an incorrect receipt and could trigger the imposition of intermediate sanctions
- Disgruntled donors could take legal action
- The charitable status of the charity that issued the receipt may also be revoked
- It remains unclear whether the intermediate sanction/penalty will be applied to a charity if it has made reasonable inquiries but the donor has not provided the required information

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4. New Definitions of Charitable Organizations and Public Foundations

- The definitions of charitable organizations and public foundations have been 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 obligations
- 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-arm’s 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. Expanded Basis for Revocation of Registration of Charities
- Proposed amendments will permit the revocation of the charitable status of a charity if it “*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, transferred in accordance with an authorized agency/joint venture/partnership agreement, or transferred to qualified donees (i.e. generally other registered charities)

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6. Charitable Annuities:

- CRA indicated in Technical News No. 26 in December 2002 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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7. Additional Qualified Donee

- The 2005 amendments propose to 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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INSTITUTE OF CHARTERED
ACCOUNTANTS OF ONTARIO
**RECENT CHANGES TO THE *INCOME TAX*
ACT AFFECTING CHARITIES**
Toronto – December 6, 2005

**Audit and New Interim Sanctions/Penalties
for Charities**

By Terrance S. Carter, B.A., LL.B.
and Karen J. Cooper, LL.B., LL.L.
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OVERVIEW

- Background
- Audit Process
- Intermediate Sanctions and Penalties
- Practical Considerations

For more information see article entitled
"Regulatory Regime - New rules seen as consistent
with recommendations of VSI" at
<http://www.canadianfundraiser.com/newsletter/article.asp?ArticleID=1792>

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BACKGROUND

- New rules concerning the taxation and administration of charities set out in the 2004 Federal Budget received Royal Assent on May 13, 2005 and are now in force:
 - New intermediate sanctions and penalties
 - New and more accessible appeals process
 - CRA's internal appeals process
 - Tax Court of Canada
 - Also new DQ rules and increased transparency previously discussed

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- Previously, CRA had only one sanction – revocation
- Relatively few audits
- Audits usually reactive, not proactive
- Audits performed by Consulting and Audit Canada, not CRA
- Budget brought increased resources to the Charities Directorate at CRA

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AUDIT/APPEALS PROCESS

- CRA is gradually providing some guidance with respect to the process related to the implementation of the new rules which it believes is consistent with the graduated educative approach to compliance recommended by the Voluntary Sector Initiative’s Joint Regulatory Table report (“VSI report”)

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- CRA’s Progressive Approach:
 1. Education (specific and general)
 2. Compliance Agreements
 3. Intermediate Sanctions
 4. Revocation

6

- **Steps in the Audit/Appeals process:**
 - 1. Organization is identified for audit**
 - **Random selection**
 - **Legislative criteria/concerns**
 - **Follow-up on non-compliance or complaints**
 - **Audit of related organization**
 - 2. Office Audit - File is screened by Charities Directorate (entails a review of information on file with CRA and internet) and, if necessary, referred for a field audit**
- 7

- 3. Field Audit**
 - **On location**
 - **Single or a team**
 - **Examination of books and records relating to bank accounts, investments, expenses, contracts, annual reports, board minutes, and any other documents related to the charity's activities**
 - **Not only an examination of financial affairs, also an examination to determine compliance with legal obligations under the ITA and if operating for charitable purposes**
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- 4. Audit Report is prepared**
 - **Quite often preliminary findings will be communicated in advance to the charity**
 - **Key document for the organization to obtain because it details the audit findings and the legal basis of any assessment of sanctions**
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5. Letter to charity advising of results

- Education – minor non-compliance
- Compliance Agreement (formerly undertaking letter)
 - Corrective action required: agreement outlines non-compliance and remedial actions that the charity must undertake and includes a paragraph that advises the charity that a penalty and/or suspension could apply if the agreement is not upheld
 - Formal document signed and dated by both parties, includes a timeframe to make changes outlined in the agreement

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6. Follow-up

- CRA may bring file forward for automatic review to ensure compliance with the agreement
- May be by office or field audit
- If compliant, file likely closed
- If non-compliant, maybe application of interim sanctions

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7. Application of Interim Sanction/Penalty

- Sanction Assessment letter
- Make payment to CRA or an eligible donee (another arm's length charity) and return sign off form to CRA once payment has been made
- Appeal

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8. Revocation

- Still available for any offence at any time and can be applied with intermediate sanctions
- The charitable status of a charity may also be revoked if it obtained its charitable registration on the basis of false, misleading or omitted information

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9. Internal Appeal

- Must file a Notice of Objection with the Assistant Commissioner of CRA's Appeals Branch within 90 days of the date of the decision's mailing
- Notice of Objection should identify the decision objected to, the reasons for the objection and all relevant facts
- Reviewed by an officer in the Appeals Branch of CRA, separate from the Charities Directorate, and the officer will have the authority to maintain, vary or disagree with the original decision
- Notice of objection is required before an appeal may be brought to the Courts

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10. Court

- Tax Court: appeals of intermediate sanctions and penalties
- Federal Court of Appeal: application for judicial review of refusals to register, revocation, annulment, and charitable designation

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PRACTICAL CONSIDERATIONS

- **Perfection is not expected or required**
- **But need to exercise due diligence**

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AUDIT DAY

- **The auditor is not your friend (or enemy)**
- **ITA 231.1 requires “all reasonable assistance”**
- **Disclose only required information**
- **Be responsive**
- **Make auditor comfortable**
- **Consider requesting written questions**
- **Document/demonstrate efforts to comply**

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BOOKS AND RECORDS

- **Financial records**
- **Receipts and supporting documentation**
- **Records demonstrating charitable nature and that all activities have a charitable purpose**
- **Keep notes and copies of all documents and correspondence**
- **Privileged documents (communications related to obtaining legal advice, does not include accountants or consultants)**

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INCOMPLETE RECEIPTS

- **Income Tax Regulation 3501 requires:**
 - Name, Registration # and address of charity
 - Serial # of receipt
 - Date and place of issue
 - Date of receipt of cash gift
 - Date of receipt and description of in-kind gift
 - Value of property received
 - Amount of advantage received by donor
 - CRA name and website URL
- See CRA Website for most recent requirements

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FALSE RECEIPTS

- Comply with new reasonable inquiry requirements
- Avoid one receipt at end of the year if multiple gifts
- Valuation issues: whose is it and can it be relied on – charity should obtain its own independent valuation
- Know your donors: Neither valuator nor charity should turn a blind eye to facts or circumstances which may give rise to concerns

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INTERMEDIATE SANCTIONS AND PENALTIES

- **Purpose of Intermediate Sanctions**
The May 2005 amendments establish a more responsive approach to the regulation of charities under the *Income Tax Act* by introducing sanctions that are more appropriate than revocation for relatively minor breaches of the *Income Tax Act*
The sanctions will apply in respect of taxation years that begin after March 22, 2004

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Offence	First Infraction	Repeated Infraction (Within 5 years)
<ul style="list-style-type: none"> Late filing or failure to file T3010A Issuing incomplete receipts Carrying on prohibited business activity <ul style="list-style-type: none"> Private foundation - any business Public foundation or charitable organization - unrelated business Foundation acquiring control of corporation Failure to comply with certain verification and enforcement requirements (e.g. keeping proper books and records) 	<ul style="list-style-type: none"> \$500 penalty Penalty of 5% of eligible amount stated on receipt Tax of 5% on gross revenue from the offending activity 5% tax on dividends paid to charity Suspension of tax receipting privileges 	<ul style="list-style-type: none"> \$500 penalty. May lead to revocation Penalty of 10% of eligible amount stated on receipt Tax of 100% on gross revenue from the offending activity and suspension of receipt privileges 100% tax on dividends paid to charity Suspension of tax receipting privileges

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Offence	First Infraction	Repeated Infraction (Within 5 years)
<ul style="list-style-type: none"> Issuing receipts in taxation year if there is no gift or if receipt contains false information Transfer among charities to avoid disbursements quota (joint and several liability with recipient charity) Undue personal benefit 	<ul style="list-style-type: none"> 125% tax on eligible amount of receipts (suspension of tax receipting privilege of total penalties under 188.1(9) exceeds \$25,000 in a taxation year) Tax of amount transferred and 10% of amount transferred Penalty of 105% of benefit 	<ul style="list-style-type: none"> 125% tax on eligible amount of receipts (suspension of tax receipting privilege of total penalties under 188.1(9) exceeds \$25,000 in a taxation year) Tax of amount transferred and 10% of amount transferred Penalty of 115% of benefit and suspension of tax receipt privileges

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UNDUE BENEFIT

- Gifts other than to qualified donee
- The amount of any “rights, income, property or resources” paid, payable, assigned or otherwise made available to member or trustee of the charity, or a person who contributed more than 50% of the capital of the charity, or a non arms length person

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- **Exceptions**
 - Reasonable remuneration or consideration for property acquired or services rendered
 - Gift made or benefit conferred in course of charitable activities unless improper eligibility
 - Gift to qualified donees Avoid excessive salaries
 - Fundraising contractors and fees
 - Grants to foreign charities – ensure appropriate agency agreements are in place

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TAX/PENALTY

- Sanctioned charity can transfer the amount of tax or penalty to CRA or to another arm's length charity (eligible donee)
- Arm's length – more than 50% of directors deal at arms length with all directors of the sanctioned charity

REVOCATION

- Still available for any offence and can be applied with intermediate sanctions
- The charitable status of a charity may also be revoked if it obtained its charitable registration status on the basis of false, misleading or omitted information

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ANNULMENT

- Where registration obtained in error or if charity ceases to be a charity because of changes in the law
 - No effect on issued receipts
 - No 100% Part V revocation tax or other penalty will be charged
- Useful tool – permits errors to be rectified without negative public notice which goes with notice of revocation

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INSTITUTE OF CHARTERED
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**RECENT CHANGES TO THE *INCOME TAX*
ACT AFFECTING CHARITIES**
Toronto – December 1, 2005

Returning a Gift – What are the Options?

By: Terrance S. Carter, B.A., LL.B.
and Karen J. Cooper, LL.B., LL.L.
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OVERVIEW

- Case Study: Radler/Queen’s Gift
- Donee Obligations
- Possible Consequences of Returning a Gift
- Options

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CASE STUDY: RADLER/QUEEN’S GIFT

FACTS (from published reports):

- Pledge in May 2000 of \$1 million to Queen’s University
- Donors include David Radler, Hollinger, and several Hollinger papers, including Kingston Whig-Standard
- \$915,180 received as of September 22, 2005
- Mr. Radler was a member of University Council

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- **Donation to be used for construction of a new business school called Goodes Hall, which opened in 2002**
- **Name on business office wing of the building and on the university’s “Benefactor Wall”**
- **Hollinger Board report indicates \$168,000 of company money was used for Radler’s part of donation**

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- **September 21, 2005 – David Radler plead guilty to fraud charges in a U.S. District Court related to his role in a \$32 million fraud at Hollinger International Inc.**
- **Under a plea bargain, he has agreed to cooperate with a continuing criminal probe into Conrad Black and other executives at Hollinger**
- **He faces possibility of 29 months imprisonment and a \$250,000 (U.S.) fine**

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- **September 22, 2005 – Queen’s announced it is stripping Mr. Radler’s name from the wing and returning the donation**
- **“[T]he integrity of this gift to the university has been compromised... the best course of action was to return the money to the individuals and corporations that had given it”**
- **The university chose not to give the money to another charity**

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OTHER EXAMPLES

- **\$1.5 million gift to Mount Sinai from Mark Valentine (broker who pleaded guilty to securities fraud)**
- **\$5 million donation to Hospital for Sick Children from Conrad Black**
- **\$1.5 million gift to Ontario’s Ridley College by Patrick Lett, sanctioned by Ontario Securities Commission – College sued by American investors on the basis that he used money fraudulently obtained to make the donation**

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LEGAL OBLIGATIONS

A. Income Tax Act

1. Donee

- **Registered charities may face revocation of their registered charity status if they fail to spend funds equal to their disbursement quota on carrying on charitable activities or making gifts to qualified donees (subsections 149.1(2), (3) and (4))**

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- **Since returning a gift is not a gift to a qualified donee and is not likely to be considered an expenditure related to carrying on charitable activities, it cannot be considered in determining whether the organization has met its disbursement quota**
- **Such a situation is not one where CRA would likely grant relief pursuant to subsection 149.1(5)**

9

- The definition of “charitable organization” requires that a charitable organization devote all of its resources to charitable activities carried on by the organization itself
- CRA statement: “Registered charities can only do two things with the money they receive: use it for their own good works or give it to another charity”

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- The only situation where CRA has published a position and considered the possibility of returning a gift is where the gift has not been completed because the charity could not satisfy the donor’s conditions - implied in the technical interpretation is a requirement that a Court order must be obtained (CRA Technical Interpretation #2005-0051761)

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- When considering the ITA implications of returning a gift, a distinction must be made between a completed gift for which a receipt has been issued and a pledge with respect to a conditional gift.
- Has the gift been completed in accordance with the law, e.g. was the gift subject to a condition precedent or a condition subsequent?
- Donee would likely be able to return the property if the gift was not complete.

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2. Donor

- **Has the gift been completed in accordance with the law, e.g. was the gift subject to a condition precedent or a condition subsequent?**
- **If the gift was not completed at the time the property was returned, CRA takes the position that it can reassess any claim for a donation deduction or credit**

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- **While each situation would be considered on a case-by-case basis, CRA has indicated that if the gift was completed it would not be entitled to reassess the donor's claim for a deduction or credit for the gift on the basis that the return of the funds would not constitute income to the donor**
- **Also, normal reassessment limitation period would apply (3 years)**

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B. Trust Law Obligations

1. Failure of the original gift?

- **There is no principle in trust law whereby a special purpose trust will fail for reasons such as those cited by the institutions.**
- **Usually, such an arrangement will come to an end if:**
 - **Restricted term becomes impossible or impractical**
 - **Limited interest in a determinable gift comes to an end**

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– **Condition precedent or subsequent is unfulfilled**

- **If condition precedent not fulfilled then gift fails**
- **If condition subsequent not fulfilled then will revert back to donor – does not appear to be the case here.**

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2. Obligations as Trustee

- **Duties of trustees / directors of charity are similar to those of ordinary trustee**
- **Directors /trustees must carry out charitable purpose in accordance with charitable objects and applicable restrictions**
- **Directors/trustees must ensure that gifts that are expended in accordance with the donor’s restrictions**

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- **Duty to secure effective use by seeking a court order to impose cy-près or administrative scheme**
- **Directors/trustees must protect and conserve trust property**
- **Must protect funds from the seizure of creditors**

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3. Breach of Trust

Examples include:

- Diverting funds intended for one charitable program for use in another charitable program
- Withholding a fund and not applying it to the charitable purpose intended by donor
- Encroaching upon the capital of endowment fund intended to be held in perpetuity
- Unilaterally attempting to alter terms of trust deed
- Using surplus funds for a different charitable purpose without court authorization
- Altering donor restriction without court approval

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- **Returning a completed gift to the donor or donors in the absence of a specific reversionary clause or gift-over would likely result in breach of trust**
- **May also result in breach of fiduciary obligations and breach of contract**

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POSSIBLE CONSEQUENCES

- **Personal liability for breach of trust**
 - **If in breach of special purpose trust for not having complied with terms then directors/trustees could be found jointly and severally liable**
 - **If found in breach of trust must compensate trust for the full amount of any loss suffered as a result of the failure to comply**

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- Remedies under the Charities Accounting Act:
 - PGT can require charity to submit accounts for formal passing s.3
 - PGT can obtain a court order to enforce directions established by donor s.4(d)
 - Member of public can complain to judge of the Ontario court who can order that the PGT conduct an inquiry. S.6(1)
 - Court can make order as “deems in the circumstances to be just” s.10

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- Income Tax Act
 - Donor may be reassessed to disallow credit/deduction in limited circumstances (would a windfall non-taxable gain be appropriate in these circumstances?)
 - Charity may face revocation

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OPTIONS

- Gift Agreement
 - Many large gift agreements contain default provisions which enable the donor to terminate unilaterally upon the happening of certain events
 - Consideration should be given to ensuring that a similar clause be included which provides the donee with the power to terminate unilaterally upon the happening of an event such as a criminal conviction, particularly if the agreement includes naming rights

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– Upon the happening of a material default, including situations such as the Radler conviction, provision could be made for a gift-over to another registered charity of qualified donee (such a provision is usually found in these agreements but always solely at the donor’s election)

– Are such agreements enforceable?

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• **Payment into Court**

– In the absence of specific provisions in a gift agreement, the money could be paid into Court and the donee could seek its guidance under Section 60 of the *Trustee’s Act*.

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• **Gift Acceptance Policy**

– include provisions dealing with such situations

• **Naming Policy**

– include strict criteria and requirements

– require removal of name in certain circumstances at the unilateral option of the institution

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