
**ONTARIO LAND TRUST ALLIANCE
WORKSHOP**

Barrie - November 3, 2006

Recent Tax Changes

By Karen J. Cooper, LL.B., LL.L., TEP
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RESOURCE MATERIALS

- Charity Law Bulletin #76 entitled "July 18, 2005 Draft Amendments to the *Income Tax Act* Affecting Charities: Part I – Definition of Gift & Split-Receipting"
- Charity Law Bulletin #77 entitled "July 18, 2005 Draft Amendments to the *Income Tax Act* Affecting Charities: Part II – Other Changes"
- Charity Law Bulletin #80 entitled "Quick List of New Tax Rules for Charities"
- Charity Law Bulletin #81 entitled "Creating a Green Legacy: The Ecological Gifts Program"

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- Charity Law Bulletin #82 entitled "Changes to Sanctions, Penalties and Appeals Process for Charities"
- Charity Law Bulletin #89 entitled "Proposed Elimination of Tax on Gifts of Public Company Shares"
- Charity Law Bulletin #94 entitled "Budget 2006: Elimination of Capital Gains Tax on Certain Gifts"
- For these and other bulletins please see www.charitylaw.ca

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OVERVIEW

A. Recent Tax Changes Affecting Gifts

- Budget 2006
- Split-receipting
- Endowed Gifts

B. Recent Structural Changes

- Intermediate Sanctions
- Appeals Regime
- New Disbursement Quota Rules (“DQ”)

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A. RECENT TAX CHANGES AFFECTING GIFTS

1. Budget 2006

- May 2, 2006, the government announced the elimination of tax on capital gains incurred on the donation of publicly listed shares and ecologically sensitive property
- Generally, a gift of property will trigger a capital gain if the FMV of the property exceeds its adjusted cost base (ACB)
- For most gifts of property, 50% of the capital gain is included in income for the year and is subject to tax

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- For example, a gift of land that an individual paid \$100 for (the ACB) and which now has a FMV of \$1,000, will result in a capital gain of \$900 and a taxable capital gain (the amount she will have to include in her taxable income) of \$450
- Assuming that she is taxed at the top marginal tax rate of 46%, she would pay \$207 in tax on the donation. Of course, she will also be able to claim a donation tax credit for the entire amount of the gift (\$1,000 - assuming that this is her only donation, the value of the tax credit would be \$460)

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- Now, with the Budget 2006 measures, a donation of publicly traded shares or an ecological gift with an ACB of \$100 and a FMV of \$1,000 will result in no taxable capital gain
- Therefore, the entire amount of the donation tax credit of \$460 will be available to be used against other sources of income
- This makes donations of such property even more attractive than cash, since the cost of the donation to individual in the first place was only \$100

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- Considerations:
 - It is important for charities and their advisors to become familiar with the impact of these changes in order to ensure that donors properly understand the tax consequences of choosing to donate such property
 - Any policy with respect to receipt of publicly traded shares should consider under which circumstances the organization might refuse to accept such a gift, for example where the business or activities of the corporation conflict with objects and values of the organization

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- Organizations which have not developed a policy in respect of receipt of donations of publicly traded shares should do so at their earliest opportunity, taking into consideration the guidance provided in *Registered Charities Newsletter No. 2 (Spring 2002)*:
 - The donor instructs their broker to transfer the shares directly to an investment account which the charity has set up with their own broker
 - The transaction should be carried out electronically where possible
 - For the purposes of valuation, use the closing bid price of the share on the date it is received or the mid-point between the high and the low trading prices for the day

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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 of or in gratitude of 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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- Naming rights
 - Naming rights are not advantages if there is no prospective economic benefit associated with the naming rights
 - CRA advance rulings
 - Corporate donors - if a corporation wishes to make a donation in exchange for the promotion of its business name, an economic benefit will result
 - Individual donors - if a private individual wishes to make a donation in exchange for the use of a family name, no economic benefit will result
 - What if the family name of the donor is very close to the family business?

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- A charity receives a gift of land from a donor who has received some type of benefit from a developer who owns property adjacent to the donated property in exchange for making the gift
- A donor who poses for pictures with his wife, a professional model, after agreeing to make a large donation to a charity. The agreement regarding the donation is publicized, various media outlets publish the pictures, and the wife of the donor receives increased modeling work as a result

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- Multiple donations by the same donor
 - In situations involving multiple donations, it is a question of fact whether any advantage received relates to a single donation or to the series
 - Sometimes, it might be necessary for separate receipts be issued for multiple donations made by the same donor
 - If the advantage relates to a series of donations, then a single receipt would need to be issued for the series of donations
 - If the advantage relates to a single donation, then it might be necessary or beneficial to issue multiple receipts

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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. Endowments

- What is an endowment?
- What are the advantages of an endowed gift?
- What are the tax implications of an endowed gift?
- What are the *income tax act* requirements of an endowed gift?

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WHAT IS AN ENDOWMENT?

- An endowment is a gift where the capital is held for at least 10 years extending for any period of time thereafter up to in perpetuity
- Normally, an endowment means that the capital is held in perpetuity
- An endowment can be created by either the donor through an endowment agreement (donor endowment agreement) or by the board of a charity initiating the creation of an endowment fund (board endowment fund)
- Under the *Income Tax Act*, an endowed gift is generally referred to as a “ten year gift” under the broader category of “enduring property”

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- The income (e.g. the interest, dividends or realized capital gains) can either be expended in total each year or can be reinvested in whole or in part
- The capital and/or the income can be restricted to a particular use, such as scholarships, or can be left unrestricted and used for the general charitable purposes of the charity
- The disbursement of income and capital by the charity can be left to the discretion of the charity or can be subject to donor advice, e.g. a donor advised fund

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WHAT ARE THE ADVANTAGES OF AN ENDOWED GIFT?

- It permits the creation of a capital fund on a long term or perpetual basis in order to fund either specific projects or the general operation of a charity
- It creates long term stability by balancing against possible fluctuations in yearly fundraising
- It allows donors to create a fund in the name of the donor or their families and have a lasting impact on charitable programs

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- It facilitates the donor acquiring naming rights in relation to the fund in question for a particular project or have naming rights placed on a building for either a specific period of time or in perpetuity
- It permits the creation of both large segregated endowed funds that are initiated by the donor, as well as smaller contributions to existing board endowed funds that are established by the charity
- If an endowment fund is operated through a parallel foundation, then the endowment fund can be protected from creditors of the operating charity

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WHAT ARE THE TAX IMPLICATIONS OF AN ENDOWED GIFT?

Enduring Property

- An endowed gift, e.g. a gift where the capital is held for at least 10 years or is a bequest or inheritance (now both part of “enduring property”) has tax implications under recent May 2005 amendments to the *Income Tax Act*

80/20 D.Q.

- An endowed gift is excluded from the 80/20 disbursement quota of the recipient charity, provided that the endowed gift is held for at least ten years

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- A transfer of an endowed gift (e.g. enduring property) between a recipient charity and another charity does not affect the 80/20 disbursement quota of either charity

3.5% D.Q.

- An endowed gift, though, will be subject to the 3.5% disbursement quota on investment assets for all foundations and for charitable organizations if the charitable organization received charitable status on or after March 23, 2004, or for charitable organizations for taxation years commencing after 2008 if they received their charitable status prior to March 23, 2004

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- The 3.5% disbursement quota only applies to those registered charities that hold investment assets greater than \$25,000

Encroachment on Enduring Property

- If interest and dividend income is not sufficient to meet the 3.5% disbursement quota, then the charity can encroach on realized capital gains up to the lesser of the capital gains pool and 3.5% of the investment assets of the charity, provided that the terms of the gift agreement permit such an encroachment during the ten year period

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- Any disbursement of realized capital gains beyond this limit or the disbursement of the original capital will result in 80% of what is expended being added back on to the disbursement quota of the charity
- It is important to ensure that the yearly calculation of the capital gains pool is kept up to date in the T3010 of a charity in order to be able to utilize the capital gains pool in the future in disbursing realized capital gains during the first 10 years of an endowed gift

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- A charity needs to carefully review existing endowment agreements to determine whether the agreement permits encroachment of realized capital gains
- If not, unless the endowment agreement reserves a right to the donor or charity to vary the terms of the endowment agreement, neither the charity nor the donor would be able to encroach on realized capital gains on their own without first obtaining court approval, as the asset no longer belongs to the donor

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Transfer of Endowed Gift

- The transfer of an endowed gift involves the transfer of enduring property and will generally be D.Q. neutral in relation to both the transferor and transferee charity
- But the transfer of enduring property can also be designated by the transferor charity as a specified gift, meaning that the transferee charity will receive the gift free of disbursement quota obligations

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- However, transfers of enduring property as a specified gift will mean that the transferor charity will have the value of the endowed gift added to its disbursement obligation in the year of the transfer but will not have any offsetting credit available to meet that increased disbursement quota in that year

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WHAT ARE THE *INCOME TAX ACT* REQUIREMENTS OF AN ENDOWED GIFT?

- It must meet the statutory requirements under the *Income Tax Act* for a ten year gift
- A ten year gift must be subject to a trust or a direction and be held for a period of not less than 10 years
- The documentation required to evidence a ten year gift must include the following:
 - The document must be executed by the donor for each gift that is made
 - The document must clearly identify the donee charity, including its official name and registration number

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- The document must indicate the amount of the gift
- The document must set out the date the gift is made
- The document must set out the name and address of the donor
- The document must set out the serial number of the official receipt issued to the donor for the gift
- The information must be attached to charity's duplicate copy of receipt

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B. STRUCTURAL CHANGES

- 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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1. 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**

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CRA’s Progressive Approach:

- 1. Education (specific and general)**
- 2. Compliance Agreements**
- 3. Intermediate Sanctions**
- 4. Revocation**

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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**

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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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2. Intermediate Sanctions And Penalties

Purpose:

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*.

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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 receiving 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 receiving 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 receiving 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 receiving 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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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

REVOCACTION

- 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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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 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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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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4. New Disbursement Quota Rules (“DQ”)

- **What is DQ?**
 - A prescribed amount that registered charities must disburse each year in order to maintain their charitable registration
- **Purpose**
 - To ensure charities use charitable funds on charitable activities
 - To discourage charities from spending excessive amounts on fundraising and from accumulating 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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- **Summary of changes to Disbursement Quota Formula:**
 - **Reduction of Disbursement Quota Rate:**
The May 2005 amendments reduce the 4.5% disbursement quota that previously applied to the capital assets of public and private foundations to a more manageable rate of 3.5%

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

- In the past, only public and private foundations were subject to a separate disbursement quota upon their capital assets not used in charitable activities
- The reduced 3.5% disbursement rate will now also apply immediately to charitable organizations registered on or after March 23, 2004 (after 2008 for charitable organizations registered before March 23, 2004)

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– **Disbursement Quota Threshold**

- The 3.5% disbursement quota will no longer apply to charities that hold investments equal to or less than \$25,000 in a given year
- This *de minimus* threshold is generally considered to be too low to be of much relief

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

- A = 80% of prior year receipted 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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NEW CONCEPT OF “ENDURING PROPERTY”

- **New term “enduring property” includes 4 types of gifts or transfers that avoid the 80% DQ**
 - **Gifts by way of bequest or inheritance, including RRSFs, RRIFs and life insurance**
 - **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

- **Includes bequests or inheritances from a donor**
- **Also 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, or
 - (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 at least ten years, i.e. endowment
- 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

- Charities are now able to encroach on the realized 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”
- 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”

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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 were subject to the 80% DQ
 - i.e. transfers from registered charities to charitable organizations were 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 other 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 100% of 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

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- For example: \$100 enduring property transferred from Charity A to Charity B

	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 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 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 \$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 for a penalty under Part V of the *Income Tax Act* 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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SOME SUGGESTIONS

- **Inter-charity transfers – transferor should not designate an enduring property as a specified gift unless it serves a purpose**
- **It is not necessary to issue a charitable receipt on inter-charity transfers**
- **Recipient charity should do due diligence**
 - **Ascertain source of a gift (from individual? from a private foundation?)**
 - **Ask if gift is ordinary gift, enduring property or specified gift**

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- **Donor charity should consider how to designate the gift having regard to its own DQ**
- **Donor agreements**
 - **Follow the formal requirements for an enduring property direction (name and address of donor; identify donee charity including name and charity registration number; indicate amount of gift; serial number of official donation receipt)**
 - **Specify if capital to be retained for 10 years or in perpetuity**

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- **Specify what is to happen to capital after 10th year if not to be held in perpetuity**
- **Provide for flexibility to permit encroachment of capital to satisfy DQ test and also to take into account possible changes to the DQ in the future**
- **Permit transfer to another charity by change of trustee if possible that might transfer whole endowment to another charity.**

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- **Capital gains pool - track capital gains on annual basis: issues re income trusts, mutual funds etc.**
- **With respect to 5 year gifts**
 - **These can only be between two charities**
 - **The recipient charity must be a charitable organization**
 - **Must be expended within 5 years**

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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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