PLANNED GIVING COUNSEL OF SIMCOE COUNTY
8TH ANNUAL FALL SYMPOSIUM

THE BUSINESS OF GIVING: WHAT YOU NEED TO KNOW

November 24, 2006

RECENT CHANGES TO THE *INCOME TAX ACT* AFFECTING CHARITIES

1. **New Disbursement Quota Rules**
2. **Proposed New Split-Receipting Rules, Due Diligence Enquiry and New Definition for Charitable Organizations and Public Foundations**
3. **Elimination of Capital Gains on Certain Gifts**

By Terrance S. Carter, B.A., 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, #80 and #85

all available at www.charitylaw.ca

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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)
- November 9, 2006 - Ways and Means Motion dealing with Inter-Charity Transfers

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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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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 in the previous years**
  - **3.5% (formerly 4.5%) for investment 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 x 0.045 [D – (E + F)]}÷365 + G
  - **September 2004 Proposed:**

    A + A.1 + A.2 + B + {C x 0.035 [D – (E + F)]}/365
  - **December 2004 / Bill C-33:**

    A + A.1 + B + B.1

    B.1 = C x 0.035 [D – (E + F)]/365

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DQ RULES PRIOR TO THE AMENDMENTS

Charitable organizations

- **80% of receipted 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 receipted 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 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 amount 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 colour DQ Chart in Charity Law Bulletin #67 for more detail

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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 MINIMIS 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 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	•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 (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 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 in transferring a DQ surplus**
- **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 foundation?)**

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-
  - **Ask if gift is ordinary gift, enduring property or specified gift**
- **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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RESOURCE MATERIALS

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- **A paper entitled "Recent Changes to the *Income Tax Act* Affecting Charities and Gift Planning" dated March 16, 2005**
- **Charity Law Bulletins #68, #76, #77, #80, #83 and #87**

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
- November 9, 2006 - Notice of Ways and Means Motion

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HIGHLIGHTS OF THE 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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- **Proposed 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 proposed 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:**

Eligible Amount of Gift = Fair Market Value of the Property Donated – Advantage Received by Donor

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

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b) 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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c) 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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- **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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- **Naming rights**
  - **Naming rights are not advantages if there is no prospective economic benefit associated with the naming rights**
  - **Corporate donors - if a corporation wishes to make a donation in exchange for the promotion of its business name, an economic benefit will result**

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– 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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- 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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d) 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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e) 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**
- **The deeming provision also does not apply**
  - **Where the gift is made as a consequence of the donor's death**

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- **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**
- **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. Due Diligence Inquiry

- **The Proposed Rule in July 2005: Charities issuing a receipt with an eligible amount in excess of $5,000 would be required to make "reasonable inquiry" of the donor**
- **November 9, 2006 Notice of Ways and Means Motion repeals 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 (see Charity Law Bulletin No. 83)**

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(a) What is involved?

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

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(c) What to ask?

- **What due diligence is required?**
- **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 acquire 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 inquiry?

- 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
- May need to issue a separate receipt for each gift where multiple gifts from a donor is involved

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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 relations, marketing and publication staff who prepare fundraising and other promotional materials that make representations 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 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 inquiry, this may 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 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 proposed draft 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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THE BUSINESS OF GIVING: WHAT YOU NEED TO KNOW

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Elimination of Capital Gains on Certain Gifts

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- **Charity Law Bulletin #89 and #94**
- **Charity Law Update – September 2006**

All available at www.charitylaw.ca

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ELIMINATION OF TAXABLE CAPITAL GAINS IN RESPECT OF CERTAIN GIFTS

1. **History of Legislative Changes**

- **In the 1997 Budget, the government reduced the inclusion rate from 50% down to 25% on capital gains arising from a gift of publicly traded shares, where the gift is to a qualified donee other than a private foundation**
- **In the 2000 Budget, the government reduced the inclusion rate from 50% down to 25% on capital gains arising from an ecological gift to a qualified donee other than a private foundation**

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- In the May 2006 Federal Budget, the Conservative government completely removed the capital gains tax on publicly listed securities donated to charities and also extended this measure to gifts of ecologically sensitive land, effective immediately

2. Implication of Changes

- Normally, a gift of property will trigger a capital gain if the FMV of the property exceeds its adjusted cost base (ACB)

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- For most gifts of property, 50% of the capital gain is included in income for the year and is subject to tax
- 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

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- 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 about $460)
- The net amount of the tax credit is $460 less $207 = $253

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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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3. Flow-Through Shares

- Flow-through shares (sometimes referred to as "FTS") are tax-based financing incentives available only to the oil and gas and mining sectors
- The current rules effectively permit corporations to renounce or "flow-through" income tax deductions associated with certain activities to shareholders in exchange for the sale of their shares

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- An investor receives shares issued by the corporation as consideration and the deductions available to the corporation in relation to resource expenditures are flowed-through to investor
- The expenditures deducted by the investor grind the cost base of the shares
- The impact of the elimination of the tax on capital gains accruing on donations of publicly traded securities when coupled with tax incentives on flow-through shares issued by companies in the resource sector has generated great interest and planning opportunities for investors in this sector

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- **Assume that the investor, instead of purchasing non-FTS securities, acquires $1,000 of FTS of a publicly listed corporation**
- **Over the course of the exploration period, the investor will be entitled to $1,000 in flowed-through deductions related to the exploration expenses resulting in tax savings of about $460 (assuming again a 46% marginal tax rate)**
- **At this point, the $1,000 FTS will have cost only $540. When exploration is completed and the investor has claimed the maximum possible amount of exploration deductions, the shares may be gifted to a qualified donee, other than a private foundation**

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- **Assuming that the value of the shares remains $1,000, the investor will be entitled to a donation tax credit in respect of the $1,000 donation, which results in another tax savings of about $460, and will not be taxed on the capital gain**
- **As a result, the investment and, thereafter, donation to charity of $1,000 will have only cost the investor/donor $80**

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- **Advisors to donors and charities with respect to such gifts should be careful when considering such gifts, since many FTS are subject to hold periods, may not retain their value during the hold period, and may not be marketable upon the expiration of the hold period**

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4. Valuation

- Determine the date of the gift of publicly traded shares:
  - Certificate hand-delivered to the charity - gift made when the charity receives and accepts gift
  - Certificate is mailed to the charity - deeming rule in paragraph 248(7)(a) applies to deem the charity to have received the certificate on the day it was mailed, provided that the charity accepts the gift

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- – Electronic transfers - CRA has indicated that as a general rule the date of a gift of electronically transferred shares is the date the shares are received in the charity's account
- Because the Act does not provide guidance in determining how a gift of shares should be valued, CRA has accepted the use of 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, whichever provides the best indicator, given the circumstances, of fair market value on normal and active market trading

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- Other factors to consider:
  - The size of the block of shares
  - The volume traded
  - The attributes of the shares
  - Whether the donor had control or was a minority shareholder
  - Whether there were any restrictions on the transferability of the shares
  - Whether the shares were thinly traded

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- Charities which anticipate receiving such gifts and 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. 12

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- With respect to ecological gifts, the date of the gift will be the date that the gift is completed, usually when title to the land is transferred or a conservation easement is registered, and the fair market value of the gift is determined by the Minister of the Environment, who issues a certificate which is applicable for the two-year period following the determination

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5. **Provincial Rules**

- Ontario tax treatment of donations of publicly-traded shares and ecological gifts will parallel the federal measures and both would be exempt from the corporate minimum tax
- Charities and advisors should continue to monitor changes to the Act in this area with respect to the extension of these measures to private foundations and to other types of property, in particular to real property

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