
BDO 2007 NATIONAL TAX SPECIALIST CONFERENCE

Toronto – January 14, 2007

SELECTIVE NEW TAX RULES FOR CHARITIES

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

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PART I – NEW DISBURSEMENT QUOTA RULES

Resource Materials

This portion of the 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, #85 and #104

all available at www.charitylaw.ca

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 – Notice of Ways and Means Motion that in part deals with Inter-Charity Transfers
- November 22, 2006 – Introduction of Bill C-33 as Draft Legislation

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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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 = $C \times .035 [D - (E + F)]$
 - 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 avoids the 80% DQ, but not the 3.5% DQ

- 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**

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- **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**
- **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**

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- **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**
- 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 (100% DQ for private foundations)
 - 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 (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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3. 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**

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4. Inter-charity transfers involving consideration

- **Bill C-33 introduced November 22, 2006 amends the *Income Tax Act* so that split receipting rules do not apply to inter-charity transfers**
- **However, it is not clear whether the amount to be factored into the DQ calculation for both the transferor and transferee is the fair market value of the gift or the net amount after deducting the debt**

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- **The amendments also mean that inter-charity transfers involving consideration between charities cannot be structured as a gift because the common law rule prohibiting consideration still applies**
- **Instead need to structure such transactions as transfer or sale, but not gifts**

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PART II – PROPOSED NEW SPLIT-RECEIPTING RULES, DUE DILIGENCE ENQUIRY

Resource Materials

This portion of the 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 #68, #76, #77, #80, #83, #87 and #104

all available at www.charitylaw.ca

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History of the 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
- November 22, 2006 - Proposed Draft Legislation Bill C-33

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Summary of 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
- 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

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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
- When dealing with inter-charity transfers involving consideration, Bill C-33 states that split receipting does not apply. Therefore, such transactions must be structured as transfers or sale, not gifts

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2. New Split Receipting Rules:

- **Charitable donation receipts must now reflect the following formula:**

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

- 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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- d) 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 taxpayer 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
- Where the donor has acquired property from a transferor (such as a spouse) on a tax-deferred rollover basis
- 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 have been required to make “reasonable inquiry” of the donor
- **November 22, 2006 Bill C-33 proposed amendments removed the above statutory requirement, but such change 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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- **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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- **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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