

HOSPITALS AND FOUNDATIONS SEMINAR SERIES
NEW DEVELOPMENTS IN PLANNED GIVING
AND CHARITY LAW

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Charity Law Update:
The Past Year in Review

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A. INTRODUCTION

This presentation provides brief highlights of the following:

- Recent changes, rulings and interpretations under the *Income Tax Act* (“ITA”)
- New policies and publications from the Charities Directorate of the Canada Revenue Agency (“CRA”)
- Federal and provincial legislative issues affecting charities
- Some of the more significant court decisions during the past year

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B. RECENT CHANGES, RULINGS AND INTERPRETATIONS UNDER THE *INCOME TAX ACT*

1. May 2006 Budget: Elimination of Tax on Gifts of Public Company Shares
 - In the 2006 Federal Budget released on May 2, 2006, the Conservative government upheld its commitment to remove the capital gains tax on publicly listed securities donated to charitable organizations and public foundations (but not private foundations), as well as extending this measure to gifts of ecologically sensitive land, effective immediately

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2. November 2006, Bill C-33 - Proposed Amendments to the *Income Tax Act* Affecting Charities

- On November 9, 2006, the Department of Finance (“Department”) released the long-awaited Notice of Ways and Means Motion to move forward with a lengthy list of proposed amendments to the ITA
- The motion was introduced as Bill C-33, and received first reading on November 22, 2006
- The proposed changes were last released by the Department on July 18, 2005, which amended and consolidated earlier proposed amendments released on December 20, 2002, December 5, 2003 and February 27, 2004

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- Some of the more significant changes proposed involve the introduction of split-receipting rules and provisions to curtail abusive donation tax shelter schemes
- The provisions contained in Bill C-33 are, for the most part, the same as the amendments released in July 2005, with a few exceptions
 - Withdrawal of Reasonable Inquiry Requirement for gifts over \$5,000
 - Inter-Charity Gifts
 - Split-receipting rules will not apply to inter-charity transfers, so common law will continue to apply

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- Where there is a gift of property involving a debt, it is not clear whether the amount to be factored into the disbursement quota calculation for both the transferor and transferee charity is the fair market value of the property being gifted or the net amount after deducting the debt
- The amendments also mean that inter-charity transfers involving consideration between charities may need to be structured as a gift because the common law rule prohibiting consideration still applies
- Instead, such transactions may need to be structured as a transfer or sale, instead of a gift

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– **Non-Application of Deemed Fair Market Value Provisions**

- **The deeming provisions will not apply where the donor has acquired property from a transferor (such as a spouse) on a tax-deferred rollover basis**

3. March 2007 Federal Budget

- **Extension of Capital Gains Exemption to Private Foundations**
 - **Budget proposes to eliminate the taxation of capital gains arising from donations of publicly-listed securities to private foundations, but not ecologically sensitive lands**

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- **Excess Business Holdings Rules**
 - **Private foundations will be required to continuously monitor their holdings and acquisitions of both publicly-listed, and private corporation shares**
 - **Safe harbour does not require monitoring if private foundation holds 2% or less of the shares of any corporation**
 - **Where a private foundation holds more than 2%, the private foundation must monitor and report any material transaction (i.e. over \$100,000 or .5%)**
 - **When over 20%, divestment requirements will apply**
 - **See presentation by Theresa Man for more details**

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- **Non-qualifying Securities**
 - **Donors of non-qualified securities to private foundations are generally not permitted a charitable donation credit or deduction until the foundation disposes of the securities**
 - **March 2007 Budget extends the rules related to donations of non-qualifying securities to a trust in respect of which the charity is a beneficiary**
 - **See Theresa Man's presentation for more detail**

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- **Loan-backs**
 - Currently, the loan-back provisions in the ITA apply when a donor makes a gift to a qualified donee and within five years of the making of the gift, the donee:
 - Acquires a non-qualifying security from the donor; or
 - Allows a donor who is not at arm's length to the charity to use the charity's property within certain time frames

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- In such instances, the donor has to reduce the eligible amount of the gift by the value of the property used, even if the donor is paying rent or giving the qualified donee something in exchange for the right to use the property
- According to Finance, some charities will accommodate arm's length donors who make their donations with the requirement that property be loaned back
- The Budget proposes to extend the loan-back rules to include arm's length donors as well, applicable to gifts made on or after March 19, 2007
- See Theresa Man's presentation for more detail

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- **Donations of Medicines**
 - Budget proposes to allow a special deduction for corporations that make donations of medicines from their inventory to registered charities that have received a disbursement under a program of the Canadian International Development Agency with respect to activities of those charities outside of Canada
 - Currently, donations by corporations of property held in inventory are eligible for a charitable donation deduction equal to the fair market value ("FMV") of the property gifted

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– However, the economic impact of this donation is reduced by virtue of the requirement in subparagraph 69(1)(b)(ii) of the *Income Tax Act* (“ITA”) to include the FMV of the item in income

– In order to provide an incentive for corporations to participate in international programs for the distribution of medicines, Finance is proposing to allow corporations that make donations of medicine from their inventory to claim a special additional deduction equal to the lesser of 50 percent of the amount, if any, by which the FMV of the donated medicines exceeds its cost and the cost of the donated medicine

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– This measure will apply to gifts made on or after March 19, 2007

4. Foundations Incurring Debts to Purchase Investments

- CRA reversed its position with respect to public and private foundations incurring debts for the purpose of acquiring investments, enabling both to now do so

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5. Meaning of “Charitable Activities”

- In a Technical Interpretation dated October 23, 2006, CRA considered the meaning of “charitable activities” for the purpose of providing guidance on the difference between expenditures on charitable activities and expenditures on management and administration when determining whether a registered charity has met its 80% disbursement quota
- In cases where expenditures are partly attributable to charitable programs and partly to management and administration, it is necessary to allocate the expenditures between these two categories and the allocation should be made on a consistent and reasonable basis

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6. Reward Points/Airline Tickets

- In a Technical Interpretation dated July 18, 2006, CRA reiterated its policy with respect to charitable donations of air travel points
 - A charity that receives premium points which qualify as a gift must include the value of the points in determining its income, and it may issue an official tax receipt for the gift
 - If a receipt is issued, the value of the premium points will be included in the calculation of the charity’s disbursement quota

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7. Private Foundations Investing in Limited Partnerships

- In an advance income tax ruling, CRA considered the issue of whether a private foundation would be considered to be carrying on a business by virtue of its foreign limited partnership such that the private foundation’s registration could be revoked pursuant to paragraph 149.1(4)(a) of the ITA
- CRA took the position that the foundation’s registration could be revoked if it was established that the foreign limited partnership was a partnership for Canadian tax purposes

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C. NEW POLICIES AND PUBLICATIONS FROM CANADA REVENUE AGENCY

1. New Policy Statement on Associated Charities

- On February 26, 2007, CRA released a Policy Statement to clarify that two unrelated charities that carry on a joint project can apply to CRA to be designated as associated charities
- The general rule for charitable organizations (as opposed to charitable foundations) is they cannot distribute more than 50% of their annual income to other charities

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- Association status means that there can be the free flow of funds between associated charities without the usual 50% limitation being applied
- Association status is available to registered charities that are:
 - 1) Related by constitution or doctrine
 - 2) Whose charitable aims or activities are substantially the same; or
 - 3) Are working together on a joint project during the duration of the joint project
- 2. New Guidelines for Applying the New Sanctions
 - On April 20, 2007, CRA released guidelines for applying the new sanctions under the ITA

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- The document sets out CRA's approach to the application of the new penalties and sanctions resulting from the amendments to the ITA in May 2005
- Until recently, the end product of an audit was either revocation of charitable status or the issuance of an undertaking letter requiring the charity to undertake certain corrective actions to become compliant
- Under the new regime, CRA will have four options to ensure compliance
 - Education, either general publications or a letter to a charity explaining its obligations under the ITA

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- A compliance agreement (similar to the undertaking letter)
- Imposition of an interim sanction or penalty
- Revocation of charitable status
- Generally, CRA will start with educational method to obtain compliance, and then move more progressively through compliance agreement, sanctions, and the ultimate sanction of revocation if necessary

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D. OTHER RECENT FEDERAL AND PROVINCIAL LEGISLATION AFFECTING CHARITIES

1. New Anti-Terrorism Legislation Passed/Granted Royal Assent

- On October 5, 2006, the Minister of Finance introduced Bill C-25
- Bill C-25 received Royal Assent on December 14, 2006

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- Some of the most important amendments in Bill C-25 that are applicable to charities and their legal counsel are amendments that will:
 - Bolster client identification, record-keeping and reporting measures applicable to financial institutions and intermediaries;
 - Allow the Financial Transactions and Reports Analysis Centre of Canada (“FINTRAC”) to disclose additional information, to both domestic and foreign law enforcement and intelligence agencies;

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- Allow CRA to disclose to FINTRAC, RCMP and the Canadian Security Intelligence Service information about charities, including identifying information of the charities’ directors and officers suspected of being involved in terrorist financing activities; and
- Exempt lawyers from reporting obligations under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*

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- The amendments will greatly increase the level of information sharing and collection among virtually all federal agencies that could potentially investigate or bring allegations and charges against charities and their directors and officers
- The amendments also highlight the increasing focus on, and investigation of, charities and their possible links to terrorism

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2. Implications of New Ontario Health Legislation for Charities

- Significant changes were made to Ontario’s health care system with the passage of Bill 36, the *Local Health System Integration Act, 2006* (the “Act”), which received Royal Assent on March 28, 2006
- Much of the Act was proclaimed into force in 2006, while sections 18 (accountability of networks), 19 (funding of health service providers) and 21 (audit) recently came into force on March 19, 2007 and April 1, 2007
- The management of local health services devolves to a series of 14 local health integration networks (“LHINs”) responsible to oversee health service providers, such as hospitals, but excluding hospital foundations

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- Sections 30 and 31 of the Act pertain to the transfer of property held for a charitable purpose by a health service provider
- Subsection 30(1) provides that if a LHIN’s integration decision or a Minister’s integration order calls for the transfer of property that the transferor holds for a charitable purpose, then all gifts, trusts, bequests, devises and grants that form part of the property being transferred will be deemed to be gifts, trusts, bequests, devises or grants of property to the transferee

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- Subsection 30(2) provides that should any of the charitable property be held by the transferor for a special purposes as specified in a will, deed or other document by which the gift, trust, bequest, devise or grant was made, the transferee entity will be required to use the property for such specified purpose, regardless of whether the transfer was made before or after section 30 came into force

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3. Proposed New Auditing Requirements Under the *Corporations Act* (Ontario)

- Under Bill 152, the *Corporations Act* (Ontario) was amended so that all non-share capital corporations, including charitable corporations, with an annual income of less than \$100,000 will no longer require an audit
- Bill 152 received Royal Assent on December 20, 2006
- The amendment is expected to be in place on August 1, 2007

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E. RECENT CASE LAW AFFECTING CHARITIES

MEANING OF CHARITY AND GIFT

1. Amateur Sport Organizations Precluded from Attaining Charitable Status
 - On April 5, 2006, in *A.Y.S.A. Amateur Youth Soccer Association v. Canada Revenue Agency*, the Federal Court of Appeal (“FCA”) released a decision with respect to the refusal of an application to register the appellant as a charitable organization
 - The purposes of the organization were to promote amateur youth soccer and offer youths the opportunity to develop pride in their ability and soccer skills

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- The appellant argued that since the common law in Ontario recognizes the promotion of amateur sport as a charitable purpose and the proposed activities are confined to Ontario, the law of Ontario should apply to the determination of its charitable status
- The FCA held that there was no need to have recourse to the common law of Ontario since the ITA provides for the tax status of the appellant which precludes the possibility of it being registered as a charitable organization
- The scheme of the ITA precludes the possibility of an amateur sport organization being registered as a charity, and only permits the separate registration of Canadian amateur athletic associations where they operate on a nation-wide basis

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- On September 21, 2006, the Supreme Court of Canada granted leave to appeal
 - The appeal to the SCC will be heard on May 16, 2007
2. Promotion of “Ethical Tourism” Not Considered Charitable
- On October 24, 2006, the Federal Court of Appeal (“FCA”) released its decision in *Travel Just v. Canada Revenue Agency*, which represents an important decision concerning what is considered to be charitable at common law

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- This case involved the refusal by CRA to register a charity with the object “to create and develop model tourism development projects that contribute to the realization of international human rights and environmental norms”
- The FCA concluded that the organization’s objects were “vague and subjective” and were not sufficiently analogous to purposes already recognised by the Courts under the fourth category of charity: i.e. other purposes beneficial to the community

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REGULATION OF CHARITIES

1. Court Decision Concerning Agency Relationships Outside of Canada

- On March 28, 2006, in *Bayit Lepletot v. Minister of National Revenue*, the Federal Court of Appeal (“FCA”) considered whether a Canadian charitable organization was carrying on its own charitable activities when it funded an orphanage in Israel of the same name through an agent
- The FCA affirmed the position that CRA has taken over the years with respect to agency relationships: it must be shown that the agent is actually carrying on the charitable works of the Canadian charity and the activities of the agent must be subject to the Canadian charity’s control

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2. Donation Tax Shelter Valuations

- On April 20, 2006, the Supreme Court of Canada dismissed an application for leave to appeal (without reasons) from the Federal Court of Appeal (“FCA”) decision in *Klotz v. Canada*, which had affirmed the Tax Court of Canada’s ruling in connection with donation tax shelter valuations
- Mr. Klotz was one of 660 people who acquired limited edition prints which were immediately donated to prescribed colleges and universities under the ITA

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- The average cost of the prints was \$300 yet the receipt that was issued was based on an average fair market value per print of about \$1,000, which the Tax Court of Canada found to be unrealistic
- The FCA agreed with the Tax Court Judge in finding that the best evidence of the fair market value of the prints was the price paid by the taxpayer not the fair market value price claimed

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3. *Khawaja* Decision Affords Little Relief for Charities Concerning Anti-terrorism Provisions

- In *R. v. Khawaja*, Mr. Justice Rutherford of the Ontario Superior Court of Justice struck down a portion of the definition of “terrorist activity” in the Code that dealt with purpose and motive
- The decision, released on October 24, 2006, was met with mixed reviews by anti-terrorism legal commentators, some of whom initially heralded the case as a powerful blow to draconian legislation

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- However, the impact upon Canadian charities of the sweeping “facilitation of terrorist activity” provision in section 83.19 of the Code is not encouraging
- The decision offers charities little relief from their susceptibility to unintentional contravention of the law because the court decided to uphold the legislation notwithstanding its breadth and the limited *mens rea* requirement concerning the definition of “facilitation”
- As a result, there are significant risks that a charity involved in conducting aid or humanitarian programs in a conflict area could unwittingly be found to still have facilitated a terrorist activity
- Application for leave to appeal was dismissed by the SCC without reasons on April 5, 2007

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Directors’ Liability and Governance

1. Non-Share Capital Corporations Must Strictly Adhere to Corporate Governance Procedures

- *Rexdale Singh Sabha Religious Centre v. Chattha*, a decision released by the Ontario Superior Court of Justice on January 24, 2006, involved a dispute over the corporate governance procedures of three inter-related non-share capital corporations

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- The three charitable organizations appealed the application judge’s order to fix the membership of the three corporations as set out in an affidavit of one of the respondent directors, as well as to require the existing directors to convene a meeting within 30 days to elect new directors by means of a fair vote
- The Ontario Court of Appeal decision was released on November 27, 2006, allowing the appeal

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- In the Court’s opinion, there had been a failure to properly change the members of the corporation in accordance with the *Corporations Act* (Ontario), and that the application judge had incorrectly concluded that four of the five directors of Rexdale were permitted to have approved the creation of a list of new members
- As well, the Court of Appeal held that where proper election of directors has not occurred, the initial incorporators would continue to be the first directors of the corporation
- While the courts came to different conclusions, both decisions illustrate that non-share capital corporations must adhere as strictly to corporate governance procedures as for-profit corporations

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2. Fairness, Reasonableness and Good Faith Expectations

- *Chu v. Scarborough Hospital Corp.* is a recent Ontario Superior Court decision released on December 28, 2006
- The decision involved a dispute between Lai Chu (“Chu”), an annual member of the Scarborough Hospital, and the hospital’s board of directors
- The decision considers several provisions of the *Corporations Act* (Ontario), the statute under which many Ontario not-for-profit organizations incorporate

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- The hospital's governance structure, classes and terms of membership, the calling of special meetings and the interpretation of by-laws were carefully canvassed by the court
- In granting Chu's application, the court included a sound admonishment of the board of directors for having acted unfairly and not in good faith toward the hospital's membership

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- In stating that "a board of directors of a *Corporations Act* corporation must interpret and apply its by-laws fairly, reasonably and in good faith," this decision joins a growing body of jurisprudence which indicates that non-share capital corporations must rigorously follow corporate governance procedures
- Fairness, reasonableness and good faith are expected at all levels of corporate life irrespective of the type of organization in question
- The trial decision was appealed to the Divisional Court of Appeal and heard on March 26, 2007
- To date, the judgement has not been released

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