
ONTARIO LAND TRUST ALLIANCE & CAROLINIAN CANADA COALITION

**It Takes Passion and Partnership
to Protect the Land We Love**

London – October 24, 2008

**Recent Tax Changes and How They
Affect Your Land Trust**

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

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OVERVIEW

- A. Elimination of Capital Gains in respect of Certain Gifts
- B. Receipting
- C. Disbursement Quota/Endowments
- D. Charitable Fundraising

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A. ELIMINATION OF TAXABLE CAPITAL GAINS IN RESPECT OF CERTAIN GIFTS

- May 2, 2006, the government announced the elimination of tax on capital gains incurred on the donation of publicly listed shares and ecologically sensitive property
- Generally, a gift of property will trigger a capital gain if the FMV of the property exceeds its adjusted cost base (ACB)

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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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B. RECEIPTING

1. Split-Receipting

- 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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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

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- Charitable donation receipts must now reflect the following formula:

Eligible Amount of Gift	=	Fair Market Value of the Property Donated	–	Advantage Received by Donor
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- Must be voluntary transfer of property with a clearly ascertainable value

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- **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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- **Broad definition of “advantage” - 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 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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– Example - 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

– Naming rights are not advantages if there is no prospective economic benefit associated with the naming rights

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2. Receipts

- CRA has released new Guidelines regarding the imposition of new intermediate sanctions: (<http://www.cra-arc.gc.ca/tax/charities/policy/newsanctions-e.html>)
- New intermediate sanction for issuing incomplete receipts could lead to a penalty of 5% of eligible amount stated on receipt (10% for subsequent infraction)
- New intermediate sanction for issuing receipts in if there is no gift or if receipt contains false information. CRA has indicated it would likely proceed directly to revocation of charitable status

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Incomplete Receipts

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

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Avoiding False Receipts

- **Valuation issues:** whose is it and can it be relied on – charity should obtain its own independent valuation
- **Know your donors:** Neither valuator nor charity should turn a blind eye to facts or circumstances which may give rise to concerns

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C. DISBURSEMENT QUOTA /ENDOWMENTS

- **What is DQ?**
 - A prescribed amount that registered charities must disburse each year in order to maintain their charitable registration
- **Purpose**
 - To ensure charities use charitable funds on charitable activities
 - To discourage charities from spending excessive amounts on fundraising and from accumulating funds

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- **80% DQ Rule:**
 - Land trusts are required to expend 80% of the previous years received donations in the following year unless the donation is a transfer of “enduring property”
- **3.5% DQ Rule**
 - Land trusts are required to expend 3.5% of their property not used in carrying out their charitable activities, e.g. investment assets, each year

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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
- 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

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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 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
- 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 charity deal at arm’s length with each director of the donee charitable organization

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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 or gift of land for conservation purposes
- 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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- For land trusts, if they do not want to be required to expend 80% of the value of a gift they receive (cash or property) for which an official donation receipt has been issued, they must ensure that the gift fits into one of the above 4 types of enduring property, usually either a bequest or a ten year gift

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WHAT IS AN ENDOWMENT?

- Generally, an endowment is a charitable trust for a restrictive purpose (i.e. a special purpose charitable trust)
- With regard to ecological gifts, an endowment can be of assistance in establishing a type of “Stewardship Fund” in order to help maintain an ecological gift of land over the years
- An endowment is a gift where the capital is held for at least 10 years but can extend beyond for any period of time up to in perpetuity

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- Normally, the term of endowment infers that the capital is held in perpetuity
- An endowment can be created by either the donor through an endowment agreement (donor endowment agreement) or by the board in initiating the creation of an endowment fund (board endowment fund)
- An endowment can be made up of capital in the form of cash, shares or any other type of property
- Under the *Income Tax Act*, an endowed gift is generally referred to as a “ten year gift” under the broader new category of “enduring property”

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

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WHAT ARE THE ADVANTAGES OF AN ENDOWED GIFT?

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

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

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WHAT ARE THE TAX IMPLICATIONS OF AN ENDOWED GIFT?

Enduring Property

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

80/20 D.Q.

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

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

3.5% D.Q.

- An endowed gift, though, will generally be subject to the 3.5% disbursement quota
- The 3.5% disbursement quota only applies to those registered charities that hold investment assets greater than \$25,000

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Encroachment on Enduring Property

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

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

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

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

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- WHAT SHOULD BE CONSIDERED IN STRUCTURING A DONOR ENDOWMENT AGREEMENT?**
- Is there a minimum amount required to establish a donor endowment agreement?
 - Is the fund created by a donor endowment agreement to consist of monies or gifts in kind, e.g. shares?
 - e.g. If it is a gift of shares, then the charity needs to ensure that there is a proper evaluation of the shares done in advance of the gift
 - Gifts of publicly traded shares will be exempt from capital gains tax

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- Is the capital of the fund to be held in perpetuity or for a period of at least 10 years?
- During the first ten years, is the charity to have the ability to encroach on realized capital gains?
- If the fund is to be held for at least 10 years, but not in perpetuity:
 - When can the capital be expended after 10 years?
 - What is the capital to be used for at that time, e.g. are there any restrictions which apply?

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• For a fund that is to be held in perpetuity, can the charity encroach on the capital after 10 years and if so, under what circumstances?

- e.g. Meeting the yearly disbursement quota shortfall
- e.g. In the event of extenuating circumstances encountered by the charity in the discretion of the board

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• Are further contributions of capital permitted and, if so, are there any limitations?

- From whom can the contributions be received?
- Are the imposition of further limitations to be permitted?
- Are there time or quantum limitations on further contributions?

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• What is the purpose of the fund, e.g. is there to be a restriction in relation to the use of the income and/or capital or can the income and/or capital be used for the general charitable purpose of the charity?

• Is the application of the income/capital to be structured as a “donor advised fund” and if so, is it clear that the board of the charity must ultimately exercise its discretion over the expenditure of the income and/or capital as opposed to that of the donor?

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• **Is the investment policy of the charity to be incorporated by reference into the endowment agreement or is the donor allowed to impose specific investment terms of reference on the gift?**

- Does the prudent investor standard from the *Trustees Act* apply?
- Does the charity have an investment policy?
- Does the charity have an agency agreement to delegate investment decision making to an investment manager?
- Is the donor able to impose restrictions on the type of investment and what happens if the restrictions no longer are prudent in the circumstances?

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• **Is the charity able to charge a reasonable administrative charge against the income of the endowment fund?**

• **Are the details of an administrative charge contained in the endowment agreement or is it to be cross-referenced to the gift policy of the charity?**

• **Does the charity have a disbursement policy to determine how much income is to be paid out each year from the endowed fund and how much is to be reinvested and under what circumstances there can be an encroachment on capitalized income and capital?**

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• **Does the endowment agreement permit a transfer of the endowed fund and change of trustee to another charity, such as a parallel foundation?**

• **Does the endowment agreement include a *cy pres* type of clause to permit the charity to change the purpose of the gift in the event that the original purpose becomes impossible or impractical?**

• **Does the endowment agreement need to include a determinable gift provision to protect the endowed gift by requiring it to be transferred to another charity in the event of the insolvency, bankruptcy or winding up of the charity?**

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- Does the endowment agreement permit amendments to the administrative terms of the agreement?
- Is the donor to be given naming rights? If so:
 - How long do the naming rights extend for?
 - Has the charity retained the right to terminate the naming rights of a donor and under what circumstance?

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WHAT SHOULD BE CONSIDERED IN STRUCTURING A BOARD ENDOWMENT FUND?

- The board of the charity should create the terms of a board endowment fund by adopting a board resolution
- There should be a board resolution to authorize each board endowment fund
- The substantive terms of a board endowment should generally be similar to the terms of a donor endowment agreement as described above

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- Example of board endowed funds could include for example
 - A perpetual endowment fund
 - A building fund
 - A debt reduction fund
 - A scholarship fund
 - A named conservation fund, such as a “Stewardship Fund”

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- Have the terms of the board endowment fund been adequately communicated to the donor in writing or is it available at the website of the charity?
- Is there some form of an endowment fund contribution agreement in order that the donor can evidence in writing that the gift meets the requirements of a ten year gift under the *Income Tax Act*?

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D. CHARITABLE FUNDRAISING

- From the media’s perspective this has become a number one compliance issue for all charities
- While the CRA accepts that charities can have fundraising costs, its expectation is that these expenses be reasonable and proportionate to the charitable activity being conducted

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- A charity which spends excessive amounts on fundraising to the detriment of its charitable programs is not considered to be devoting all of its resources to charitable activities
- Additionally, spending excessive amounts on fundraising results in disbursement quota shortfalls and often deliberate, incorrect categorization of expenses (i.e., including fundraising expenses as a charitable program expenditure)

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- On March 31, 2008, CRA released a Consultation Paper for a Proposed Policy on Fundraising (“Fundraising Policy”) to provide registered charities with information pertaining to the use of resources for fundraising and the limits imposed by law

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- Allocation of fundraising expenses vs charitable expenses
 - In general, charities are to report on their T3010A return as fundraising expenditures all costs related to any activity that includes a solicitation of support or is undertaken as part of the planning and preparation for future solicitations of support, unless it can be demonstrated that the activity would have been undertaken without the solicitation of support

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- To demonstrate that the activity would have been undertaken without the solicitation of support, charities must demonstrate either A or B below:
 - A. Substantially all of the resources devoted to the activity advance an objective other than fundraising
 - or
 - B. All of the following apply to the activity:
 1. The main objective of the activity was not fundraising based on the resources devoted to fundraising in the activity, the nature of the activity, or the resources used to carry it out

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2. The activity does not include ongoing or repeated requests, emotive requests, gift incentives, donor premiums, or other fundraising merchandise

3. The audience was selected for reasons other than their ability to give

4. Commission-based remuneration or compensation derived from the number or amount of donations is not being used

– Where the test in A is met, all costs for the activity may be allocated as non-fundraising expenditures on the T3010A return

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– Where the tests in B are met, a portion of the costs for the activity may be allocated on the T3010A return as non-fundraising expenditures, and a portion as fundraising expenditures

– In some instances, even if the activity would not have been undertaken without the solicitation of support, charities may be allowed to allocate a portion of the costs other than to fundraising expenditures, where the activity also demonstrably furthers one of the charity’s purposes

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• The Fundraising Policy sets out:

- Conduct considered as decreasing the risk of unacceptable fundraising (e.g. prudent planning process, good staffing process, etc.)
- Conduct considered as increasing the risk of unacceptable fundraising, e.g.
 - Sole-sourced fundraising contracts and/or non-arm’s length fundraising contracts without proof of fair market value
 - Activities where most of the gross revenues go to contracted non-charitable parties

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- Commission-based fundraiser remuneration or payment of fundraisers based on amount or number of donations
- Total resources devoted to fundraising exceeding total resources devoted to program activities
- Misrepresentations in fundraising solicitations or disclosures about fundraising or financial performance
- Combined fundraising and charitable program activity, where contracted to a party that is not a registered charity or that is compensated based on fundraising performance

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- Other circumstances that the CRA may consider (presumably as mitigating factors)
 - Small charities or charities with limited appeal
 - Charities that are investing resources in donor acquisition or other types of fundraising in which the return will not be realized in the same year in which the investment is made
 - Charities whose main or major purpose is to make gifts to qualified donees, or to one or more registered charities and as a result have a different cost structure than charities that carry on their own activities

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- Charities whose activities include lotteries or charitable gaming that is regulated provincially
 - Charities engaging in cause-related marketing initiatives
 - Charities with extraordinary spending, relative to their size, on infrastructure to ensure compliance with this fundraising policy
- The Fundraising Policy sets out an evaluation grid, which is based upon a ratio of fundraising costs to fundraising revenue, which is different than the 80/20 disbursement quota

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– The ratio of fundraising costs to fundraising revenue during a fiscal period will place a charity in one of five categories ranging from rarely acceptable to acceptable:

- Rarely acceptable: More than 70% (charity nets less than 30%)
- Generally not acceptable: 50% to 70% (charity nets 30% to 50%)
- Potentially not acceptable: 35.1% to 49.9% (charity nets 50.1% to 64.9 %)
- Generally acceptable 20% to 35% (charity nets 65% to 80%)
- Acceptable Less than 20% (charity nets more than 80%)

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