
ONTARIO LAND TRUST ALLIANCE (OLTA)

“Strong Foundations: Together We Can!”

Barrie – October 30, 2009

Recent Tax Changes

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

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OVERVIEW

A. Receipting
 B. Disbursement Quota
 C. Endowments and Stewardship Funds
 D. Fundraising

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A. 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:

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

- 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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B. DISBURSEMENT QUOTA RULES

- **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 receipted 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, eg. 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 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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- “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
 - Where an individual has designated a charity as a direct beneficiary of an RRSP, RRIF or life insurance policy
 - 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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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
- 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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C. ENDOWMENTS AND STEWARDSHIP FUNDS

WHAT IS AN ENDOWMENT?

- In its simplest form, an endowment is a restricted long term gift to a charity that is to be invested and used for the charity's purpose

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- Some endowments are directed to be held in perpetuity, while others are directed to be held for a fixed number of years
- An endowment is either directed to be used for a particular purpose, such as a maintenance of a particular property, or otherwise for the general charitable purposes of the land trust

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- Endowments, can be subject to a right of encroachment on capital if the donor has built that right into the endowment agreement
- An endowment can be created by:
 - An *inter-vivos* ten year gift under the ITA;
 - or
 - A testamentary gift in the form of a bequest
- Both ten year gifts and testamentary gifts are types of enduring property under the ITA to which the 80% DQ does not apply

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- A ten year gift under the ITA is a gift established in writing by a donor pursuant to a trust or direction whereby the capital and any property substitute therefore must be held for a period of at least 10 years
- If an endowment is not a ten year gift, then 80% of the endowment would need to be added to the DQ of the charity in the following taxation year after the gift is made
- However, an endowment, whether as a ten year gift or as a testamentary gift, remains subject to a separate 3.5% DQ under the ITA that applies to investment assets

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- An endowment functions as a charitable trust for a restricted purpose, i.e., a requirement to hold monies or property for a specific period of time (or in perpetuity), as well as possibly being held for a specific application (maintenance of a particular property)
- The charity has no authority to vary the terms of a charitable trust unless:
 - The document creating the endowment permits the charity to modify the terms of the charitable trust; or

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- The charity applies for a variation of the trust from the court, possibly using section 13.1 of the *Charities Accounting Act* for a simplified procedure
- Variation of terms of a charitable trust other than as indicated above may expose the directors to allegations of a breach of trust

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WHAT OPTIONS ARE AVAILABLE?

A. Avoid the Restrictions of a Ten Year Gift

- Check to see if the 10 year time restriction of a ten year gift has expired
 - Each ten year gift must be separately tracked
 - Read the terms of the endowment agreement to see when the 10 year time restriction expires
 - If the 10 years (or whatever time restriction imposed by the donor) has expired, then the capital of the 10 year gift can be expended

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- See if the endowment agreement consists of other types of enduring property
 - Other types of enduring property that do not have a ten year restriction but still avoid the 80% DQ include:
 - Bequests
 - Insurance
 - RRSPs
 - RRIFs
 - If the endowment is enduring property but is not a ten year gift, then it is not subject to a ten year minimum hold period and can be expended

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- Carry any DQ surplus forward or back in the event of a current year DQ shortfall
 - A DQ surplus can be carried forward 5 years or back 1 year
 - If there is a current DQ shortfall, then if there is a DQ surplus accumulated from the previous 5 year, use the earlier DQ surplus to offset DQ shortfall in the current year
 - Alternatively, if it is anticipated that there will be a DQ surplus in the following year, the anticipated DQ surplus next year can be brought back to offset the current year DQ surplus

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- If there is still a DQ deficit after the charity has exhausted the above options, the charity may seek relief from DQ requirements in the current year under sub-section 149.1(5) of the ITA
 - A charity can only seek relief at the end of the present taxation year after the current year T3010 has been filed
 - The relief is only granted if the current year DQ shortfall is the result of circumstances beyond the charity’s control
 - See CRA Policy Commentary CPC-029 for more detail at <http://www.cra-arc.gc.ca/tx/chrts/plev/cpc/cpc-029-eng.html>

B. Encroachment on Ten Year Gifts to Meet 3.5% DQ

- If the endowment agreement so provides in writing, the charity can encroach on the capital of a ten year gift in order to meet the 3.5% DQ of a charity even if it has a DQ surplus
- The charity will need to add 80% of the encroachment on capital onto the 80% DQ of the charity, meaning that the charity will generally end up with a larger DQ deficit

- However, the charity can avoid an 80% DQ inclusion when encroaching on capital, provided that the charity has tracked and applied its “capital gains pool” and such encroachment on capital does not exceed the 3.5% DQ of the charity for that taxation year
- The capital gains pool is a notional account used to track realized capital gains from all forms of enduring property, not just ten year gifts

- It is therefore advisable for a charity to keep track of its capital gains pool account
- If the endowment agreement permits a charity to encroach upon a ten year gift beyond the 3.5% DQ, then the gift in question might not qualify as a ten year gift, which would mean that 80% of the total gift might need to be added onto the 80% DQ of the charity in the first place

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D. CRA GUIDANCE ON FUNDRAISING BY REGISTERED CHARITIES

a) Introduction

- Final form of policy released June 11, 2009
- The policy was developed in response to a growing demand for the media and the general public for more accountability from charities on their fundraising tricks

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- The policy provides information on the current treatment of fundraising under the ITA and under common law provides guidance on:
 - Distinguishing between fundraising and other expenditures
 - Allocating expenditures for the purpose of reporting them on the T3010
 - Dealing with activities that have more than one purpose
 - Understanding how CRA assesses what is acceptable fundraising activity, what may preclude registration or what may result in a sanction, penalty or revocation

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- CRA has advised that the policy, once released, does not represent a new policy position of CRA but simply a confirmation of their existing policy
- As such, the policy will have impact on current audits, not just future audits
- The policy is intended to provide general guidelines only

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- The policy applies to all registered charities
- Applies to both receipted and non receipted fundraising
- Charities must still meet other obligations, such as disbursement quota
- The policy is based on principles established by caselaw that fundraising must be a means-to-an-end, rather than an end-in-itself

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b) Fundraising and Charitable Purposes

- All registered charities are required by law to have exclusively charitable purposes
- The ITA does not define what is charitable
- Courts have determined that fundraising is not charitable in-and-of-itself
- Therefore, direct fundraising costs generally cannot be reported as charitable expenditures
- Fundraising activities which are appended to activities primarily directed at achieving a charitable purpose can be allocated between charitable and fundraising for purposes of reporting

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c) What is Fundraising

- **As a general rule, fundraising is any activity that:**
 - **Includes a solicitation of support for cash or in-kind donations (solicitations of support include sales of goods or services to raise funds)**
 - **Is part of the research and planning for future solicitations of support; or**
 - **Is related to solicitation of support (efforts to raise the profile of a charity, donor stewardship, donor recognition, etc.)**
- **Fundraising includes activities carried out by the registered charity, or someone acting on its behalf**

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d) Prohibited Conduct

- **Two prohibited fundraising activities not dealt with in this policy**
 - **To fundraise as an unrelated business**
 - **To fundraise, or otherwise make its resources available, to support terrorism**
- **The following prohibited conduct related to fundraising activities are the principal grounds for revocation of a registered charity's status, imposition of sanctions or other compliance actions, or for denial of charitable registration**

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- i. Conduct that is illegal or contrary to public policy**
- ii. Conduct that is a main, or independent purpose of the charity**
- iii. Conduct that results in more than an incidental or proportionate private benefit to individuals or corporations**
- iv. Conduct that is deceptive**

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e) Allocation of Fundraising Expenses

- In general, charities are to report on their T3010A return (as well as the new T3010B for year ends after January 1, 2009) 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
- Does not include asking for funding from governments

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- A fundraising activity can be
 - A single action (e.g. an advertisement published in a newspaper) or a series of related actions (e.g. a capital campaign)
 - An external activity (e.g. telemarketing, direct mail, putting on events, distributing information through the media or a charity's own publications)
 - An internal activity, such as hiring fundraisers, and fundraising activities carried out by staff or volunteers

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- A "solicitation of support" is any statement or representation made for the purpose of seeking a voluntary donation, regardless of whether or not a donation receipt is issued – includes:
 - Costs associated with acknowledgement or thanking donors, unless the value and cost of the recognition is nominal and its purpose is merely to acknowledge the gift
 - Costs associated with stewardship initiatives - i.e. when a charity invests resources in relationships with past donors in the expectation or hope that they will make additional gifts - e.g. where a donor receives access to information, services, or privileges not generally available to the public

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- Research and planning for future solicitations of support
- Goods and services to prompt or reward a donation
- Sale of goods and services other than to serve the charity’s beneficiaries and is not fulfilling its objects
- A membership program for people to join as a member upon making a donation, or where there is extensive use of donation incentives or premiums to promote joining as a member

- In order to demonstrate that an activity would have been undertaken without the solicitation of support, a charity must demonstrate that it meets either Test A (the “Substantially All Test”) or Test B (the “Four Part Test”)
- Test A: Substantially All Test – where substantially all of the resources are devoted to the activity to advance an objective other than fundraising

- Test A (Substantially All Test)
 - “Substantially all” is considered 90% or more
 - “Resources” includes the total of a charity’s financial assets and everything the charity can use to further its purposes (e.g. its staff, volunteers, directors, premises, and equipment)
 - Amount of resources devoted to an activity is determined by the content, prominence given to the material, and costs associated with carrying out the activity

- **Test B: Four Part Test** – where the answers to all of the following questions is “no”
 - i. Was the main objective of the activity fundraising?
 - ii. Did the activity include ongoing or repeated requests, emotive requests, gift incentives, donor premiums, or other fundraising merchandise?
 - iii. Was the audience for the activity selected because of their ability to give? and
 - iv. Was commission-based remuneration or compensation derived from the number or amount of donations used?

- **Test B (Four Part Test)**
 - The background document provides extensive explanation on each part of the Four Part Test
 - Specifically, Part 1 of the Four Part Test involves two assessment criteria, with the second criteria in turn involving four further criteria
 - As well, Part 2 of the Four Part Test involves three aspects of an activity
 - As such, the Four Part Test can be very challenging to work through

- Where Test A (Substantially All Test) is met, all costs for the activity may be allocated as non-fundraising expenditures on the T3010 return
- Where Test B (Four Part Test) is met, a portion of the costs for the activity may be allocated on the T3010 return as non-fundraising expenditures and a portion as fundraising expenditures
- f) Evaluation of fundraising activities
 - Fundraising revenues include amounts reported in T3010 on line 4500 (receipted income) and line 4630 (all other income from fundraising)

- Fundraising expenditures include amounts reported on line 5020 as fundraising expenses
- “Resources” are not defined in the *Income Tax Act*
- CRA considers “resources” to include all financial assets plus all other assets which can be used to further the charity’s purposes
 - e.g. staff, volunteers, directors, premises, equipment, supplies

- Where input costs related to each objective will be discrete (e.g. different staff persons within a charity prepare different parts of a publication), these costs can be reported as separate costs in accordance with how they are allocated by the charity in its bookkeeping
- Where costs will not be discrete (e.g. the costs of printing or mailing are for all the materials regardless of its objective), these costs should be allocated in proportion to the amount of content devoted to each objective

g) Fundraising Ratios and the Approach of CRA

- Fundraising ratios are used as an “initial tool” based upon a ratio of fundraising costs to fundraising revenue on an annual basis (not based on the 80/20 disbursement quota)
- The ratio will place a charity in one of three categories
 - Under 35%: Unlikely to generate questions or concerns by CRA
 - 35% and above: The higher the ratio, the more likely there will be concerns
 - Above 70%: This level will raise concerns and is rarely acceptable. The charity must be able to provide an explanation and rationale to show that it is in compliance

- CRA assessment of a charity's fundraising will take into consideration the following factors:
 - The size of the charity which may have an impact on fundraising efficiency
 - Causes with limited appeal which could create particular fundraising challenges
 - Donor acquisition and planned giving campaigns which could result in situations where the financial returns are only realized in later years

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h) Factors in Evaluating Fundraising Activity

- The policy indicates that the fundraising ratio is only an **initial** tool in assessing the acceptability of a charity's fundraising and CRA will examine the charity's fundraising conduct before concluding whether a charity's fundraising is or is not acceptable
- Factors include
 - Best practice conduct that decreases the risk of CRA finding that there is unacceptable fundraising
 - Conduct or indicator that increases the risk of CRA finding that there is unacceptable fundraising

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- Conduct considered as decreasing the risk of CRA finding that there is unacceptable fundraising
 - Prudent planning processes
 - Appropriate procurement processes
 - Good staffing processes
 - Ongoing management and supervision of fundraising practice
 - Adequate evaluation processes
 - Use made of volunteer time and volunteered services or resources
 - Disclosure of fundraising costs, revenues and practice (including cause-related or social marketing arrangements)

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- **Conduct or indicators that could cause CRA to further review a charity’s fundraising activities**
 - **Sole-sourced fundraising contracts without proof of fair market value**
 - **Non-arm’s length fundraising contracts without proof of fair market value**
 - **Fundraising initiatives or arrangements that are not well-documented**
 - **Fundraising merchandise purchases that are not at arms length, not at fair market value, or not purchased to increase fundraising revenue**

- **Activities where most of the gross revenues go to contracted non-charitable parties**
- **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**
- **Each of the above types of conduct or indicators is explained in detail in the background document**

- i) **Commentary**
 - **Many of the requirements, determinative factors and criteria contained in the policy and background document are open to subjective interpretation and accordingly, there may be inconsistencies in the administration of the policy and audit of charities**
 - **The evaluation ratio is based on fundraising costs and revenue on an annual basis, but does not take into account the fact that the nature of fundraising activities of charities varies widely, depending on their objects, structure and resources, etc. – perhaps a rolling average approach would be more appropriate**

- The policy and background document are complicated and may be difficult for registered charities to understand and comply with
- The evaluation ratio used is different from the disbursement quota under the ITA – the proposed policy should explain how the elements in the ratio relate to the calculation of disbursement quota
- Greater focus will be required on disclosure of fundraising costs, revenues and practices
- Total resources devoted to fundraising should not exceed total resources devoted to programs activities

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- Best practices – as identified by the CRA – should be adopted whenever possible
- Prohibited fundraising conduct should be avoided and any of the indicators attracting CRA review should be avoided whenever possible
- Internal evaluation of each fundraising activity should be carried out and tracked throughout each fiscal year and beyond in order to ensure overall compliance

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