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# GIFTING ISSUES

February 4, 2015

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This paper reviews a number of interesting cases in 2014 relating to charitable gifts, as well as changes to the *Income Tax Act* ("ITA") that have profound impact on testamentary gifts.

## A. RECENT CASE LAW RELATED TO GIFTING ISSUES

In 2014, a number of cases touched on issues related to gift giving in Canada. This set of case law includes commentary from the British Columbia Court of Appeal on whether a donor can demand money back from a charity if CRA disallowed the associated potential tax credit, as well as to what extent a conditional donation agreement can give rise to a testamentary disposition or an *inter vivos* trust. Additionally, the Tax Court of Canada dealt with a number of cases involving fraudulent donation receipts, including, in particular, a recent series of seven judgements released in November in which the Tax Court considered a donation scheme operated by the same tax preparer involving the issuance of approximately $12 million in false charitable donation receipts. The court in these seven cases emphasized that even though the tax preparer involved in the scheme was the instigator, individual taxpayers remain responsible for their own tax returns despite the bad advice.

### 1. <u>Gift at Common Law vs Gift for Income Tax Purposes - Neville Case</u>

In *Neville v National Foundation for Christian Leadership*, the British Columbia Court of Appeal ("BCCA") considered an appeal by Ken and Monica Neville (the "Nevilles") concerning whether the National Foundation for Christian Leadership ("NFCL") had to return two donations made to it by the Nevilles.[1] On May 29, 2014, the Supreme Court of Canada denied, without reasons, leave

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[1] 2014 BCCA 38 (CanLII), confirming *Neville v National Foundation for Christian Leadership*, 2013 BCSC 183 (CanLII).

to appeal. This case arose after Canada Revenue Agency ("CRA") denied a tax credit for the donations.[2]

NFCL operated a program whereby students who attended Trinity Western University or other Christian post-secondary institutions and solicited donations for NFCL; and thereafter they nearly always received a corresponding bursary or scholarship from NFCL for the expenses related to their education. The scholarships were generally 80% of the lesser of the students' educational expenses and the funds that they had solicited. Some students were awarded scholarships equal to 100%.

In 2002, the Nevilles made two donations in the total amount of $6,250 to NFCL and received a tax receipt for the amount of the donations. Following the donations, their daughter received two scholarships from NFCL in 2002 and 2003 totalling $6,408. In 2005, CRA disallowed the tax credit for the donations on the basis that the donations were not gifts because they were intended to directly or indirectly benefit a person who was not dealing at arms' length with the Nevilles.[3] The Nevilles and others in similar circumstances contested this finding in the Tax Court of Canada in 2010 and the Federal Court of Appeal in 2011, but both attempts were unsuccessful. Leave to appeal to the Supreme Court of Canada was refused. Although a donation could not be earmarked by the donor for a particular student, the Tax Court of Canada found, on the basis of NFCL's pamphlets, that the donors either knew or ought to have known that if they made a donation to NFCL, their children or grandchildren would receive a bursary or scholarship that would defray the expenses of their education. Based on the principles in *The Queen v Friedberg*, the Court also held that a gift is a gratuitous transfer of property by the donor in return for which no benefit flows to the donor.[4] After applying a multi-factor test, the Court held that the strength of the link between the benefit to the donors and their donations was sufficiently strong to disqualify their "donations" from being "gifts" for the purpose of subsections 110.1(1) and 118.1(3) of the ITA.

Once the litigation with CRA concluded, the Nevilles sued NFCL in the British Columbia Supreme Court ("BCSC") for a refund of the donations. The Court held that the donations were gifts at

[2] *Coleman v Canada*, 2010 TCC 109, 2010 DTC 1096; *Coleman v Canada*, 2011 FCA 82, 332 DLR (4th) 530; *Ballard v Canada*, [2011] SCCA No 196.
[3] *Neville v National Foundation for Christian Leadership*, 2013 BCSC 183 (CanLII) at para 3.
[4] 92 DTC 6031, 6032 (FCA).

common law even though they are not gifts for income tax purposes because "the essential elements of a gift [at common law]…are that one gives, that there is delivery of the gift and that the person to whom the gift has been made accepts."[5]

The Court then held that the failure of the gift to attract a tax benefit does not vitiate the gift.[6] In this regard, the Nevilles argued that the gifts were made for the purpose of attracting a tax benefit and that this purpose was not fulfilled because NFCL paid bursary and scholarship funds to their daughter. The Nevilles therefore argued that the gift should be returned since its purpose was not fulfilled. The Court rejected this argument, stating that the Nevilles' purpose in making the gift was to donate to a foundation that supported Christian students attending Christian schools. It also stated that it was clear that the Nevilles understood that their daughter would receive a scholarship or bursary from NFCL and that there was no guarantee of a tax benefit. The Court noted that although the Nevilles did not receive the tax benefit they had hoped for, that was not the purpose of the gift, although it may have furnished a partial motivation. Accordingly, the primary purpose of the gift was fulfilled and the gift was not vitiated. In particular, NFCL did nothing to vitiate the gift. Rather, it was CRA's actions that "vitiated not the gift but its tax exempt status."[7]

The Nevilles also alleged that the gift should be returned because it was held in trust by NFCL. The Court held that the gifts were not impressed with any sort of express, implied, resulting or constructive trust that might justify returning the gifts to the Nevilles upon their failure to avoid tax. The Court also held that even if the donations were not a gift, there was no unjust enrichment because the Nevilles received a bursary for their daughter and a tax receipt, which was what they had expected to receive. Moreover, the loss of the tax benefit enriched the Government, not the Nevilles.

The applicants appealed their case to the BCCA, which found that the trial judge did not err and dismissed the appeal. They then sought leave to appeal to the SCC, which also denied leave to appeal. According to CRA's website, NFCL has been inactive for a number of years.

[5] *Supra* note 3 at paras 25 and 26.
[6] *Ibid* at para 27.
[7] *Ibid* at para 31.

This case shows that a material benefit associated by a gift could disqualify a gift for income tax purposes. Even though the facts in this case indicate that the donations could not be earmarked by the donors for particular students, the Court, nevertheless, found, based on other facts before the Court, that the donors either knew or ought to have known that their donations would result in a benefit to them.

This case is also interesting in that a gift that does not qualify for income tax purposes may still qualify for common law purposes. In situations where CRA disallows a tax benefit under the ITA, donors will still need to be aware that this does not necessarily justify that the charity should return the gift. As such, donors who intend for their donations to receive tax benefits under the ITA should be careful to ensure that the donations will qualify as gifts both at common law and under the ITA.

To take this decision one step further, since the Court found that the donations were gifts at common law, this means that the gifts are charitable property and must therefore be applied to further the charitable purposes of the charity. As such, this would, in turn, mean that the charity would not be able to return the gift to the donors. To do so may result in the charity risking being challenged for paying charitable property to non-qualified donees for a non-charitable purpose and the directors being exposed to liability that may arise as a result of breach of trust. The circumstances under which a gift may be returned and the consequences faced by the charity and its directors involve a complex area of law, a review of which is outside the scope of this paper.[8] As well, where a gift is returned by a charity to the donor, subsections 118.1(25) to (28) and subsections 110.1(14) to (17) of the ITA that were introduced by the Federal Budget in 2011 allow CRA to reassess and disallow the donor's credit/deduction associated with the gift if it was returned after March 21, 2011. As well, the ITA also requires the charity to file an information

[8] For an overview, see Kate Lazier and Andrew Valentine, "Considerations Involved with the Return of a Gift" (Paper presented at the 2010 National Charity Law Symposium, Canadian Bar Association/Ontario Bar Association, 30 April 2010) [unpublished]; and Ryan M Prendergast, "Looking a Gift Horse in the Mouth: What to Do With "Bad" Donations" Charity Law Bulletin No. 227 (29 September 2010), online: <http://www.carters.ca/pub/bulletin/charity/2010/chylb227.pdf>.

return within 90 days if the property has a fair market value greater than $50.[9] According to CRA's Guidance, the "information return" required by the ITA is simply a letter to CRA.[10]

2. Conditional Gift - Norman Estate Case

In June 2014, the BCCA considered the validity of a donation provided for pursuant to a conditional donation agreement. In *Norman Estate v Watch Tower Bible and Tract Society of Canada*, the BCCA agreed with the trial judge's decision that the conditional gift in question was an *inter vivos* gift rather than a testamentary gift, meaning it took effect during the lifetime of the donors.[11] Consequently, the Watch Tower Bible and Tract Society (the "Society") was entitled to keep the gift.

Lloyd and Lily Norman (the "Normans") made regular monetary gifts to the Society, which is a registered charity. On June 5, 2001, Mr. Norman sent a $200,000 cheque to the Society indicating "For N.I. Demand Loan" in the memo line, with a cover letter stating "My understanding of such a loan ..., in the case of an emergency, or other, the return of such a portion can be requested. Otherwise, on the death of both parties of the suppliers of loan, these funds will remain the property of the [Society]." The Society responded to the Normans and explained two different possible arrangements: an "Interest-Free Demand Loan" arrangement whereby the remaining balance of the loan upon the death of the lender would be turned over to the estate for distribution under the will and a "Conditional Donation" arrangement whereby the remaining balance of the loan would automatically remain with the Society upon the death of the lender. The Normans and the Society subsequently entered into a conditional donation agreement to confirm the latter arrangement that the remaining balance would be the property of the Society upon the death of the survivor of the Normans. Subsequent to the agreement, the Normans loaned a total of $310,000 to the Society, of which $60,000 was turned into outright gifts for which the Society issued donation receipts. Mr. Norman survived his wife. On Mr. Norman's death, a balance of $250,000 remained from the funds advanced under the agreement. The Society issued a charitable donation receipt for $250,000,

[9] See also *Income Tax Regulations*, CRC, c 945, s. 3501.1.
[10] Canada Revenue Agency, "Qualified donees – Consequences of returning donated property" Guidance, CG-016, (19 October 2012), online: <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/rtrng-dntd-prpty-eng.html>.
[11] 2014 BCCA 277 (CanLII) [*Norman*, BCCA]; confirming 2013 BCSC 2099 (CanLII) [*Norman*, BCSC].

but Mr. Norman's estate (the "Estate") claimed that the Society was not entitled to the $250,000 and sued for the return of the funds to the Estate.

The issue before the Court was whether the agreement between the Normans and the Society was a testamentary disposition or an *inter vivos* trust. Both parties agreed that if the agreement had created a testamentary disposition, then it would be invalid because it was signed without witnesses and, therefore, did not comply with the British Columbia *Wills Act*.[12] The Estate claimed that the agreement was testamentary so that the $250,000 had to be returned to the Normans; while the Society argued that the agreement was an *inter vivos* trust which the Normans intended to have immediate effect upon execution and thereby the Society was entitled to retain the $250,000. The trial judge held that the agreement created an *inter vivos* trust because the Normans intended the agreement to have immediate effect and the agreement created gifts with a subsequent condition. The Estate appealed but the appeal was dismissed.

In the process of reaching her decision, the trial judge held that the correct test for evaluating whether a disposition is testamentary continues to be set out in *Cock v Cooke*. This test states that to determine the nature of a disposition, a court must first consider whether the person who executed the disposition intended that it only take effect after his or her death and then examine whether the gift is dependent on the death of the donor for its vigour and effect.[13]

The trial judge also referred to the following principles that have emerged regarding testamentary dispositions.[14] These principles include:

- Whether a disposition is testamentary depends on the intention of the maker;[15]

- The intention of the maker is a question of fact (the court is not restricted to considering the wording of the document alone, but can and should consider extrinsic evidence relevant to the transaction);[16]

[12] RSBC 1996, c 489.
[13] (1886) LR 1P 241 at 243 in *Norman*, BCSC, *supra* note 11 at para 20.
[14] *Norman*, BCSC, *supra* note 11 at paras 23-24.
[15] *Wonnacott v Loewen* (1990), 1990 CanLII 976 (BCCA), 44 BCLR (2d) 23 at para 19.
[16] *Ibid* at para 20.

- A document is testamentary if it is not intended to have any operation until the maker's death;[17]

- A document is not testamentary if it is intended to have and does have the effect of transferring some present interest in the property or of setting up a trust at the present time;[18]

- Reserving a right to revoke the transfer or bring a trust to a close does not necessarily have the effect of making the document testamentary;[19]

- Cases where documents are held to be testamentary often include the following factual elements: 1) no consideration passes; 2) the document has no immediate effect; 3) the document is revocable; and 4) the position of the donor and donee does not immediately change;[20]

- Even where an intended disposition is revocable by the maker or where enjoyment of it is postponed until the death of the maker, if, at the time of its execution, the document can legally pass an immediate interest in the property, no matter how slight, the transaction is not testamentary;[21]

- The level of control the donor exercises over the property is an important factor;[22] and

- The central question is whether the maker intended the document to pass some immediate interest or whether the maker intended the document to have no effect until his death.[23]

The trial judge concluded that the gift was an *inter vivos* trust because the Normans made the gift during their lifetime with the intent that the gift would be effective immediately. In reaching this decision, the trial judge pointed to the Normans' cover letter, which said that upon the Normans'

[17] *Ibid* at para 19.
[18] *Ibid*.
[19] *Ibid*.
[20] *Ibid* at para 21.
[21] James MacKenzie, *Feeney's Canadian Law of Wills*, 4th ed. (Markham, ON: LexisNexis Canada Inc, 2000), para 1.20.
[22] *Ibid* at 1.25–1.27.
[23] *Mordo v Nitting*, 2006 BCSC 1761 (CanLII) at para 335.

deaths “these funds will remain the property” of the Society.[24] The trial judge used the “guiding principle” of considering whether the donor intended that the gifts should be dependent on his death. The judge held that the agreement evidences a gift with a subsequent condition that creates an *inter vivos* trust.

On appeal, the BCCA held that the Estate failed to demonstrate that the trial judge made a palpable and overriding error in finding the Normans’ intention, on an objective interpretation of the agreement and in the surrounding circumstances, was to transfer an immediate proprietary interest in the donations to the Society. In upholding the trial decision, Justice MacKenzie of the BCCA referenced the trial judge’s statement that:

> The Conditional Donation Agreement on its face did have immediate effect and the extrinsic evidence is consistent with that conclusion. The Conditional Donation Agreement itself was not revocable, although the Normans had the right to a refund of their donations in accordance with its terms... the [Society] obtained both an immediate and future interest in the funds and the Normans’ rights in respect of the funds became subject to the Conditional Donation Agreement.[25]

In this regard, the BCCA agreed with the trial judge’s decision that the gift was a transfer of a proprietary interest to the Society during the Normans’ lifetimes and therefore the transfer was *inter vivos* based on the following findings: the Normans were bound by the terms of the agreement, which they could not revoke at any point; the Normans did not have the unrestricted opportunity to dispose of the property as they saw fit; the Normans could revoke their donations, but only in compliance with the terms of the agreement; the Normans could not revoke the agreement itself; and the Society could spend the funds at its discretion in the interim.[26] As a result, the Society was entitled to keep the funds in question.

On the one hand, this case shows that it is possible for a conditional donation agreement to be entered into in order to create a charitable gift remaining with the charity after the death of the donor. On the other hand, if the donor’s intention is to lend funds to a charity with the remaining balance of the loaned funds to be repaid by the charity to the donor’s estate, then the agreement should be clearly drafted to reflect such an intention. To avoid unnecessary litigation between the

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[24] *Norman*, BCSC, *supra* note 11 at paras 27 and 41.
[25] *Norman*, BCCA, *supra* note 11 at para 28 from *Norman*, BCSC, *supra* note 11 at para 54.
[26] *Norman*, BCCA, *supra* note 11 at para 34.

charity and the donor's estate, it would be prudent for charities to seek legal advice to have proper documents put in place for both arrangements so that the appropriate set of documents can be used depending on the intention of the charity and the donor in each case.

3. Recent False Receipting Cases

The Tax Court of Canada released a number of cases in 2014 involving fraudulent receipting, cumulating in the release of 7 cases at the same time in November considering a donation scheme operated by the same tax preparer involving the issuance of approximately $12 million in false charitable donation receipts.

a) Seven Cases in November 2014

In November 2014, the Tax Court of Canada released seven judgements dealing with false receipting heard over 3 days before the same judge in September 2014. All of these cases relate to a fraudulent tax donation scheme operated by an accounting and tax services corporation in Vancouver. The scheme involved the issuance of approximately $12 million in false charitable donation receipts. The set of cases are: *Abootaleby-Pour v The Queen*,[27] *Bani v The Queen*,[28] *Izkendar v The Queen*,[29] *Vekkal v The Queen* [*Vekkal*],[30] *Rasuli v The Queen*,[31] *Nocon v The Queen* [*Nocon*],[32] and *Komarynsky v The Queen*[33] (collectively referred to as the "Appellants"). In each of these cases, CRA took the position that the receipts for the charitable donations were forged. The Court disallowed the false receipts in all cases.

This series of cases is important in underscoring that individual taxpayers cannot be protected behind a screen of bad financial advice. It further shows that taxpayers cannot use excuses such as bad advice, misguided trust, momentary lapses of judgment, or not reviewing their returns. Individuals must take responsibility for their own actions and roles within the tax system.

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[27] 2014 TCC 343 [*Abootaleby-Pour*].
[28] 2014 TCC 340 [*Bani*].
[29] 2014 TCC 344 [*Izkendar*].
[30] 2014 TCC 341 [*Vekkal*].
[31] 2014 TCC 346 [*Rasuli*].
[32] 2014 TCC 345 [*Nocon*].
[33] 2014 TCC 342.

In all of the cases, the Minister alleged that the Appellants purchased false charitable donation receipts from their accountants, Fareed Raza and Sheem Raza (the "Accountants") at various times during the period 2003 to 2009. The Accountants were charged with fraud for making false statements on the related income tax returns. The Appellants have the onus of disproving the Minister's assumptions, while the Respondent has the burden of establishing that the Appellants made a misrepresentation attributable to neglect, carelessness, or willful default under paragraph 152(4)(a)(i) of the ITA.

CRA presented common evidence in all seven cases. In 2009, CRA's Vancouver Tax Services Office discovered that a number of the Accountants' clients had made large donations to the Mehfuz Children Welfare Trust (the "Trust"). The donation pattern appeared abnormal because the taxpayers' donations represented a significant portion of their net income (between 8 to 11%).[34] In 2010, CRA launched a criminal investigation, from which CRA uncovered that receipts for the Trust seized at the Accountants' offices were different from the official receipts issued by the Trust. The charitable status of the Trust was voluntarily revoked in October 2012.

The exact details regarding circumstances of the donations and the tax returns prepared by the Accountants vary in each of the 7 cases, but the result was the same. In reaching the decisions to disallow the receipts, the Court was satisfied that the Appellants knowingly purchased false donation receipts, knowingly made false representations in respect of the donations, and cannot deny responsibility because they did not read the tax returns prepared by the Accountants or placed their trust in a third party preparer of income tax returns. For example, in *Nocon*, the Court found that Mr. Nocon was equally blameworthy, and cannot shift the blame to the Accountants.[35] The judge emphasized that "taxpayers cannot be absolved of responsibilities for misrepresentations made in their tax returns on the grounds that they failed to read the return before they signed and filed them."[36] The judge also emphasized that it is implausible that the Appellant in *Izkendar* would give the Accountants money in cash immediately after learning about the charity,[37] and that some Appellants were not in the financial position to make the alleged donations.[38]

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[34] *Bani*, *supra* note 28 at para 9.
[35] *Supra* note 32.
[36] *Abootaleby-Pour, supra* note 27 at para 22.
[37] *Izkendar, supra* note 29 at para 19.
[38] *Vekkal, supra* note 30 at para 29; *Rasuli, supra* note 31 at para 25.

In *Vekkal*, the Court concluded that while the Accountants instigated the false donation receipt scheme, the Appellants "should not be spared."[39] The judge referred to the full analysis in *Vekkal* throughout the other shortened cases. In *Vekkal*, the judge stated that "Parliament has made it clear that taxpayer conduct of this sort is not acceptable. Fiscal disobedience is a societal concern."[40] The judge specifically referred to the Supreme Court of Canada's finding in *Knox Contracting Ltd v Canada*, where the Supreme Court stated that:

> Those who [. . .] evade the payment of income tax not only cheat the State of what is owing to it, but inevitably increase the burden placed upon the honest taxpayers. It is ironic that those who evade payment of taxes think nothing of availing themselves of the innumerable services which the State provides by means of taxes collected from others.
>
> The entire system of levying and collecting income tax is dependent upon the integrity of the taxpayer in reporting and assessing income. If the system is to work, the returns must be honestly completed. [. . .][41]

b) Other Cases in 2014

Similarly, the Tax Court of Canada also released a number of other cases in 2014, with various fact scenarios, that also involve inflated fraudulent donation receipts. The following is a brief summary of some of these cases.

In May 2014, the Court in *Hassan v The Queen* denied a claim for charitable tax credit for donations totalling $25,000 purportedly made to Operation Save Canada's Teenagers in 2009.[42] The charitable status of this organization was revoked in 2011 after a CRA audit found that the charity had improperly issued receipts for amounts greater than the amounts donated or for transactions that do not qualify as gifts under the ITA.

Mr. Hassan claimed that he had made a pledge at the end of 2009 to make $25,000 of donations by the end of 2010. His donations were allegedly made in cash, although the Court noted that Hassan's bank statements and schedule did not line up with his alleged cash donations. Additionally, the Court found that the receipt for $25,000 was based upon an alleged $300

[39] *Supra* note 30 at para 36.
[40] *Ibid*.
[41] [1990] 2 SCR 338, 1990 CanLII 71 (SCC).
[42] 2014 TCC 144.

donation, which it did not believe was made at all, and the $25,000 pledge, which is not permitted under the ITA for the issuance of a charitable receipt. The Court also found that the donation receipt did not satisfy the prescribed information requirements and included a wrong name, lacked a clear description of the location of where the gift was made, and contained an incorrect amount and a wrong or missing date. Although it was unclear to the Court whether Mr. Hassan was complicit or merely duped, the Court found that "it appears almost certain that the program involved a fraud on the Canadian tax system, and therefore on the Canadian public."[43] According to CRA's website, the charitable status of Operation Save Canada's Teenagers was revoked in May 2011.[44]

In June, July and August 2014, the Tax Court of Canada released its decisions in another series of cases involving fraudulent receipts in *Ampomah v The Queen,*[45] *McCalla v The Queen,*[46] *Akinbo v The Queen,*[47] *Imoh v The Queen,*[48] *and Bello v The Queen.*[49] *Ampomah* and *McCalla* were heard on common evidence involving cash donations made to the Jesus Healing Center, *Akinbo* involved cash donations made to the Israelite Church of Christ Canada, and *Imoh* involved cash donations while *Bello* involved cash and cheque donations to Revival Time Ministries and Revival Time Ministries International. Although these judgments result from Informal Procedure appeals (i.e., the decisions hold no precedential value), these cases are helpful to show the importance of donors being able to provide objective evidence to support charitable donation credits or deductions claimed and that the evidence is verifiable.

The cases involved donations that represented a large percentage of the donors' incomes. For example, in 2006, Ms. Ampomah received donation receipt for $18,200, which represented 21% of her net income in that year; in 2007 and 2008, Pauline and Howard McCalla claimed charitable donations of between 5 to 11% of their annual net incomes; and in 2006 Mr. Akinbo claimed a

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[43] *Ibid* at 10.
[44] Canada Revenue Agency's website indicates that the charitable status of Operation Save Canada's Teenagers was revoked because it was the "view of the Canada Revenue Agency that the Organization has improperly issued receipts for amounts greater than the amounts donated, issued receipts for transactions that do not qualify as gifts or are otherwise not in accordance with the Act and its Regulations; has failed to maintain and provide adequate records to support its activities and has provided falsified bank statements to the CRA."
[45] 2014 TCC 217 [*Ampomah*].
[46] 2014 TCC 199 [*McCalla*].
[47] 2014 TCC 214.
[48] 2014 TCC 258.
[49] *Ibid*. Heard on common evidence with *Imoh v The Queen*.

cash donation of $3824.10. However, the Court found that none of the appellants provided sufficient and credible evidence to meet the onus and demonstrate they made donations in the amounts claimed on their tax returns. The Court cited various evidentiary problems including: failing to call a witness with knowledge of events (*Akinbo*, *Imoh*); strength of CRA's audit evidence (*McCalla, Imoh*); improbability of donation amounts based on net income (*Ampomah*); lack of connection to the donee charity (*Akinbo*); inconsistent statements; and general lack of documentary evidence to corroborate claims. The Court in *McCalla* held that the appellants had not discharged on the balance of probabilities the onus they have before the Court by not providing any objective evidence to confront the Minister's assumption that the cash donations were not made. In this regard, the Court referred to the judgement in *Patel v Canada* in that while "there was nothing illegal about making a donation in cash," "when a taxpayer chooses to deal only in cash, whether for charitable donations or any other matters likely to come under the scrutiny of the Minister of National Revenue, [the taxpayer] imposes on [oneself] the burden of having some means of verifying the otherwise untraceable transactions."[50]

In *Imoh* and *Bello*, the Court also found that the charities involved had provided falsified bank statements and was unable to validate any of the donations made by Mr. Imoh or Mr. Bello. In *Akinbo, Imoh and Bello*, the Court did not believe that donations were actually made and dismissed the appeals; as such the Court did not see the need to address whether the donation receipts issued complied with the requirements in the Income Tax Regulations.

In *Ampomah* and *McCalla*, however, the Count found that the donation receipts did not comply with the requirements in the Income Tax Regulations. Ms. Ampomah and the McCallas argued that their good faith should negate the receipting deficiencies. The Court rejected these arguments because "it is not a matter of fault, responsibility, good faith or bad faith," but it is mandatory that receipts must comply with the requirements in ITA and the Regulations.[51]

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[50] *McCalla supra* note 46 at paras 17 and 18, citing *Patel v Canada*, 2011 TCC 555 at para 16.
[51] *Supra* note 46 at para 15.

Interestingly, the charitable status of all charities involved in these cases was revoked by CRA. Jesus Healing Center was revoked in May 2009;[52] Israelite Church of Christ Canada was revoked in January 2011,[53] and Revival Time Ministries Int. was revoked in January 2011.[54] The Court in *Imoh* and *Bello* noted that Daniel Mokwe involved in Revival Time Ministries Int. was referred by CRA for criminal prosecution charges but he fled Canada before the charges were laid.

On April 15, 2014, the Tax Court of Canada released a decision in *David et al v The Queen,*[55] where the Court issued one set of reasons for 6 Informal Procedure appeals concerning alleged charitable gifts made to CanAfrica International Foundation ("CanAfrica") involving a tax return preparer. In 2006, the tax return preparer solicited the appellants to make donations to CanAfrica in exchange for inflated tax receipts. At the time of the donations, CanAfrica was a registered charity, although its status was revoked in 2007.

As a starting point, the Minister assumed that the appellants paid 10% of the face amount of the receipts and an additional unspecified amount as a commission. The Court sought evidence by the appellants to refute this assumption. The appellants did not provide any contemporaneous documentation (such as copies of cheques) to corroborate their own "self-interested testimony."[56] The Court found the testimonies of the appellants too vague, too brief to be convincing, and implausible. The Court concluded that each appellant had actually donated only 10% of the face value of the tax receipts and accepted inflated tax receipts from CanAfrica. The Court rejected the appellants' argument that they should be allowed a tax credit based on the face amount of the inflated tax receipts issued because they should have been warned by CRA regarding concerns

[52] Canada Revenue Agency's website indicates that the charitable status of Jesus Healing Center was revoked because CRA's "audit revealed that the Charity lacked control over the donation receipts, did not devote all its resources to charitable purposes and activities, failed to maintain proper books and records, and was unable to demonstrate adequate direction and control over its foreign activities."
[53] Canada Revenue Agency's website indicates that the charitable status of Israelite Church of Christ Canada was revoked because CRA's "audit has revealed that the Israelite Church of Christ Canada (the Organization) was not complying with the requirements set out in the Income Tax Act (the Act). In particular, it was found that the Organization had failed to maintain proper books and records, issued donation receipts for amounts that were not gifts, and issued donation receipts for non-cash gifts with incomplete information."
[54] Canada Revenue Agency's website indicates that the charitable status of Revival Time Ministries Int. was revoked because it is " the view of the Canada Revenue Agency (CRA) that the Organization has improperly issued receipts for amounts greater than the amounts donated, issued receipts for transactions that do not qualify as gifts or are otherwise not in accordance with the Act and its Regulations; has failed to maintain and provide adequate records to support its activities and has provided falsified bank statements to the CRA."
[55] 2014 TCC 117.
[56] *Ibid* at para 14.

about CanAfrica. The Court held that even if it agreed that CRA should have provided a warning, a tax credit can only be claimed to the extent provided by the ITA. However, the Court rejected the Minister's argument that an inflated tax receipt should be regarded as a benefit that would negate a gift. The Court allowed the charitable tax credit for 10% of the receipt's face amount. Although the Court did not have the jurisdiction to waive interest on the tax owing, the Court vacated all penalties levied against the appellants.

## B. NEW ESTATE DONATION RULES INTRODUCED BY BUDGET 2014

While the ITA provides tax relief to a donor for charitable gifts made during his or her lifetime, where gifts are made as a result of the donor's death, the tax relief is even greater. As a result, making charitable testamentary gifts has always been an attractive estate planning tool under certain circumstances. Such gifts may be done in a variety of ways, including outright legacies and bequests from the residue of an estate, or gifts made from a spousal trust after the intervening life interest of the surviving spouse.

The Federal Budget 2014 ("Budget 2014"), released in February 2014, included a number of tax incentives that are intended to encourage testamentary charitable giving. In particular, more flexibility will be provided to charitable donations made by will for income tax purposes.[57] These new estate donation rules are coupled with new rules regarding how testamentary trusts are taxed. The new rules apply to deaths that occur after 2015. However, as explained in this paper, the implications of these new rules may, in some circumstances, discourage charitable giving on death rather than encourage it.[58]

Another change introduced by Budget 2014 related to charitable gifts is widening the definition of "total charitable gift" to include gifts made by an individual's spouse or common-law partner. This change reflects current CRA practice. This same change is also proposed for the definitions of

[57] Ministry of Finance, *The Road to Balance: Creating Jobs and Opportunities – Economic Action Plan 2014* (Ottawa: Ministry of Finance, February 11, 2014) [*The Road to Balance*].
[58] While articles written shortly after the release of Budget 2014 seem to applaud the changes introduced in the Budget, recent articles seem to point out various potential negative impacts of the new rules. See for example M. Elena Hoffstein and Pearl Schusheim, "New Testamentary Tax Rules," presentation to the Jewish Foundation Professional Advisory Committee Seminar, November 18, 2014; Brenda Lee-Kennedy, "Overhauling post-mortem charitable giving in Canada" Your Guide to Charitable Giving & Estate Planning at 14; and M. Elena Hoffstein and Brenda Lee-Kennedy, "A new era for post-mortem philanthropy in Canada" 23:1 *STEP Journal* at 50-51.

"total ecological gifts" and "total cultural gifts," which refer to charitable gifts of qualifying land and cultural property.

Draft proposed amendments to the ITA on the new estate donation rules were released on August 29, 2014, by the Department of Finance for consultation. These changes are now embodied in Bill C-43, *Economic Action Plan 2014, No. 2* ("Bill C-43"), which received Royal Assent on December 16, 2014.[59]

Other new rules introduced by Budget 2014 which impact charitable giving include doubling the 5-year carry-forward period for gifts of ecologically sensitive land to ten years, and removing the exemption for gifts of cultural property made as part of a tax shelter gifting arrangement from the rule that deems the value of a gift to be no greater than its cost to the donor.[60] These changes are contained in Bill C-31, *Economic Action Plan 2014 Act, No. 1*, which received Royal Assent on June 19, 2014.[61]

This paper will only review the new rules in relation to estate gifts under Bill C-43.

1. Current Rules For Deaths Before 2016

The tax rules governing estate gifts in place before Budget 2014 will continue to apply for gifts that arise as a result of deaths that occur before 2016.

In this regard, subsection 118.1(5) of the ITA deems a gift made by an individual through a will (a "gift by will") to have been made by the individual immediately *before* he or she died.[62] Subsection 118.1(4) of the ITA provides that a gift made in the year of death is deemed to have been made in the year immediately prior to death to the extent that the tax credit for the gift has

[59] *A second Act to implement certain provisions of the budget tabled in Parliament on February 11, 2014 and other measures*, 2nd Sess, 41st Parl, 2013-14 (assented to 16 December 2014).
[60] These changes apply to gifts made after February 10, 2014.
[61] *An Act to implement certain provisions of the budget tabled in Parliament on February 11, 2014 and other measures*, 2nd Sess, 41st Parl, 2013-14 (assented to 19 June 2014), SC 2014, c 20.
[62] RSC, 1985, c 1 (5th Supp) [ITA].

not been claimed in the year of death.[63] This would allow the donation tax credit to be claimed in the individual's terminal tax return or in the year immediately prior to death.

The value of a non-cash donation is based on its fair-market value on the date of death, not the date when the charity received the gifted property. Where the value of the gifted property was changed after death, this may give rise to valuation issues when the charity issues the donation tax receipt.

Where an individual designated a qualified donee (e.g., a registered charity) as the recipient of the proceeds under a Registered Retirement Savings Plan (RRSP), Registered Retirement Income Fund (RRIF), Tax-Free Savings Account (TFSA) or life insurance policy, donation tax credits will also be available. In this regard, if the transfer of the gift to the qualified donee occurs within 36 months after death, then the gift would be deemed to be made immediately before the individual's death.

The limits that apply in determining a taxpayer's total donations that are creditable in a year also apply to gifts made by will under subsection 118.1(5). Generally, the maximum amount of donations that may be claimed in a year is 75% of an individual's net income. Subsection 118.1(1) provides that the 75% limit does not apply in the year of the donor's death and the immediately preceding year. Therefore, donations made in the year of the donor's death and the immediately preceding year could be deducted up to 100% of the deceased's income in those years.

On the other hand, where a gift made as a result of a person's death does not satisfy as a gift by will, the tax credit for a gift made by the estate of a deceased person may be claimed by the estate.[64] However, a gift made by an estate may only be entitled to a charitable donation credit pursuant to subsection 118.1(3) up to 75% of the income of the estate.

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[63] *Ibid*.

[64] In some situations, a gift made from a testamentary trust to a charity may not be treated as a gift, but may be treated as a distribution in satisfaction of the charity's income interest in the trust or as a distribution in satisfaction of the charity's capital interest in the trust. See M. Elena Hoffstein, "Legal Analysis," in "Making donations through a will or trust: Struggling with CRA interpretations" (Fall 2004) 4:1 *Step Inside*; and D Bruce Ball and Brenda R Dietrich, "Bequests and Estate Planning in Personal Tax Planning" (1999) 47:4 *Canadian Tax Journal,* 995-1018.

In some situations, a gift made from a testamentary trust to a charity may not be treated as a gift at all, but may be treated as a distribution in satisfaction of the charity's income interest in the trust or as a distribution in satisfaction of the charity's capital interest in the trust. If a charity is receiving a property distribution in this manner, then neither the deceased nor the deceased's estate can claim a donation credit.

Because of the additional tax benefits of gifts made by will that are available under subsection 118.1(5), determining whether a gift qualifies as a gift by will has been a key consideration in estate planning in order to obtain the desired tax results. However, such a determination has been a complex area because there is little case law dealing with what would constitute a gift by will. The interpretation of this subsection has been, for the most part, in accordance with the position taken by CRA in its various interpretation bulletins, technical interpretations and rulings. The following provides a succinct summary of CRA's position:

> The Canada Revenue Agency has issued many publications outlining its position as to what constitutes a Gift by Will, and in general, requires that: (i) the terms of the will provide for a donation of a specific property, a specific amount or a specific percentage of the residue of the estate; (ii) it is clear from the terms of the will that the executors are required to make the donation; (iii) the estate is in a position to make the donation after the payment of debts; and (iv) the donation is actually made.[65]

Conversely, CRA would generally determine that a gift is made by the estate where the estate trustee has the discretion to determine the amount of gift, whether a gift is to be made, and the charity to which to make the gift. However, CRA does not appear to have a systematic policy on the requirements of what would qualify as a gift made by will or a gift by the estate. Rather, CRA has dealt with this on a case-by-case basis.

Another problem with the estate donation rules in the ITA prior to Budget 2014 was that they were not flexible enough regarding when a donation tax credit was available. This often led to situations where a donation tax credit could be available in years when there were insufficient taxes owing

[65] M. Elena Hoffstein and Laura West, "Federal Budget 2014 and Changes to Testamentary Charitable Giving" *Charity Talk* (14 October 14 2014), online: <http://www.cba.org/CBA/sections_charities/news2014/budget2014.aspx>. For more information, see also Laura West, "Gifts By Will" *Healthcare Philanthropy: Check-Up 2013* (11 June 2013), online: <http://goo.gl/DkRvUB>.

to make use of the credit. Consequently, the estate could be unable to match tax liabilities with available donation credits.

2. New Rules For Death After 2015

Budget 2014 introduced new rules to govern testamentary gifts as a result of deaths that occur after 2015. Under these rules, all estate gifts (regardless of whether they would otherwise be categorized as gifts by will or gifts by the estate under the old regime) will be deemed to be made by the estate at the time at which the gift property is transferred to a qualified donee. The same deeming rules will also apply to designated donations (gifts made through RRSPs, RRIFs, TFSAs and life insurance policies).

As such, the value of a non-cash donation will be based on its fair-market value on the date of the transfer, rather than the date of death as in was under the previous regime.

The new rules will provide greater flexibility in claiming donation tax credits if the gift meets all of the following requirements:

- The gift must be made by the deceased's "graduated rate estate."
- The gift must be transferred to a qualified donee within the first 36 months after the individual's death. This requirement coincides with the fact that an individual's estate only qualifies to be a graduated rate estate for 36 months after death.
- The property must have been received by the estate on and as a consequence of the individual's death or have been subtitled for such property.

To provide flexibility regarding the tax treatment of such gifts, the new rules will allow the estate trustee to allocate the donation made by will among any of the following: (a) the taxation year of the estate in which the donation is made; (b) an earlier taxation year of the estate; (c) the terminal or last taxation year of the deceased person, or (d) the year before the terminal year of the deceased person.[66] Since the graduated rate estate can only exist for 3 years, this means that the estate trustee

[66] *The Road to Balance, supra* note 57 at 333.

can allocate the gift within a maximum of 5-year time frame, being 2 years prior to death and 3 years after death.

In this regard, Budget 2014 introduced a new concept of a "graduated rate estate" (a "GRE"), which is an estate that arises on and as a consequence of the death of an individual, qualifies as a testamentary trust, provides for the social insurance number of the deceased individual on the estate's tax return, and is designated by the estate as a GRE in its first estate tax return that ends after 2015. An estate will only qualify to be a GRE for 36 months from the date of the individual's death. Only one estate can be designated as the GRE for a deceased individual. The GRE will be taxed at graduated tax rate and can have an off-calendar year, among other features. This means that gifts that qualify for the new estate donation rules must be made by GREs. Other than GREs and "qualified disability trusts",[67] all other trusts (including testamentary trusts that do not qualify as GREs, estates and *inter vivos* trusts) will be taxed the flat top marginal rate, must have a calendar year end, must remit quarterly instalments, cannot claim the $40,000 basic exemption for alternate minimum tax, and will be subject to Part XII.2 tax on certain income.[68]

The current rule that donations made in the year of the donor's death and the immediately preceding year could be deducted up to 100% of the deceased's income in those years will continue to apply. An estate will continue to be able to claim a donation tax credit in respect of other donations in the year in which the donation is made or in any of the five following years.

Specifically, subsection 118.1 has been amended to effect these new rules. As well, paragraphs 38(a.1)(ii), 38(a.2)(ii) and 39(1)(a)(i.1) will also be amended in relation to testamentary gifts of securities, ecological gifts and gifts of cultural property.

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[67] A "qualified disability trust" is a trust with beneficiaries who qualify for the disability tax credit.

[68] Budget 2014 also introduced new tax rules on the taxation of trusts. A review of these rules is outside the scope of this paper. For a review of how these rules negatively impact the administration of estates and estate planning, see: M. Elena Hoffstein and Pearl Schusheim, "New Testamentary Tax Rules" presentation to the Jewish Foundation Professional Advisory Committee Seminar (18 November 2014);
Tax Insights from High Net Worth/Private Company Services, "New tax rules for testamentary trusts: The bad and the good (and some surprises)" Issue 2014-34, PricewaterhouseCoopers, online: <http://www.pwc.com/en_CA/ca/tax-insights/publications/pwc-new-tax-rules-for-testamentary-trusts-2014-09-en.pdf>; and Lisa Heddema, Angela Ross and Pamela Cross, "Beware: A New Era in Estate Planning, Qualified Disability Trusts, Graduated Rate Estates, Life Interest Trust Taxation" STEP Canada, Webcast (14 November 2014).

3. Implications of the New Rules

The new estate donation rules provide greater flexibility in a number of respects, however there are many unanswered issues, and concerns still remain.

One of the welcome changes of the new estate donation rules is the flexibility for estate trustees to allocate the charitable tax credits for charitable gifts over a maximum of 5 years (i.e., 2 years before death and 3 years of the GRE after the death of the taxpayer).

Another welcome change is that the new rules provide greater certainty on the date of a testamentary gift by prescribing that the date of the gift is the date when the gift is received by the charity. Under the old regime, the date of a gift by will is generally the date of death, regardless of when the gift is received by the charity. In practice, the old regime may create hardship in certain situations, especially where the value of the property had depreciated by the time the charity received the gifted property. As such, the new rules would provide greater certainty for charities when they issue donation receipts for testamentary receipts.

The fact that all testamentary gifts will be deemed to be gifts made by the estate appeared, at first blush, to be a welcome change because the proposal avoided the need to determine whether a gift is a gift by will or a gift by estate as was required under the old regime. However, the changes did not expressly clarify this issue. As such, it would be preferable for the ITA to expressly clarify that the new rules are intended to apply to all testamentary gifts regardless of whether they qualify as gifts by will or gifts by estate under the current regime.

The new rules require that the gifted property must have been received by the estate on and as a consequence of the individual's death or have been subtitled for such property. This will in turn mean that the estate cannot borrow funds in order to make a qualifying estate gift. This may cause hardship in certain situations, for example where the estate's funds are somehow tied up for more than 3 years and the estate would be prevented from borrowing funds to make the gifts before the 36 month limit runs out.

Another challenging issue in applying the new estate donation rules is that only gifts made within 36 months after death will be eligible for allocation within a 5 year time frame. This will impose greater pressure on estate trustees to administer the estate as soon as possible within this time frame if they want to take advantage of the greater tax benefits under the new rules. However, in practice, there are many situations where a gift may not be able to be made within this period and the 36 month period does not do justice to taking these circumstances into account. Examples of such circumstances include the time required to obtain a clearance certificate (which may take a year or more in some jurisdictions), the time required to resolve estate disputes or litigation, the time required to seek direction from the court to clarify the terms of the will, or the time required to dispose of an illiquid asset (such as real estate, art work, or private company shares). If an estate cannot effect the transfer of a gift within 36 months, the donation tax credit is only available to the estate for the year of the transfer. There are various potential solutions suggested by the sector to address this problematic issue. For example, CRA could be given an administrative power to allow it to extend the 36 month period upon application to CRA,[69] or the ITA could be amended to remove the 36 month distribution requirement from estate gifts all together. It has also be suggested that where an individual does not anticipate that his or her estate could make the desired testamentary gift within the 36 month period, there might be an increase in the use of private foundations or short-term or bridge donor advised funds in estate plans.[70]

Another highly problematic issue is that the new rules do not specifically deal with the treatment of gifts to a charity on the death of an intervening life interest (commonly referred to as charitable remainder trusts). In the case of qualifying spousal trusts, the donation will be deferred until the death of the surviving spouse. Such a gift can qualify as a gift by will under the current regime if the trustees have no right to encroach on the capital in favour of the life tenant. Although a residual interest in a charitable remainder trust is a property interest that can be transferred to a charity within three years of death, it is only that property interest that is transferred to the charity on death, while the actual underlying property of the charitable remainder trust cannot be transferred until after the death of the life tenant.

[69] Canadian Association of Gift Planners, Submission to the House of Commons Standing Committee on Finance (1 August 2014) online: <http://www.parl.gc.ca/Content/HOC/Committee/412/FINA/WebDoc/WD6615327/412_FINA_PBC2014_Briefs%5CCanadianAssociationOfGiftPlanners-e.pdf>; Canadian Association of Gift Planners, letter to Department of Finance, (29 September 2014).
[70] Malcom Burrows, "Tax Deadlines & Charities," *All About Estates* (12 December 2014), online: <http://www.allaboutestates.ca/estate-planning/tax-deadlines-charities/>.

With the new estate donation rules not applying until death occurring after 2015, it remains to be seen whether the ITA will be amended in 2015 to address these issues.