THE 2007 ANNUAL
CHURCH & CHARITY LAW™ SEMINAR

Toronto – November 7, 2007

Highlights in Charity Law:
The Year in Review

(Current as of October 10, 2007)

By Jacqueline M. Demczur, B.A., LL.B.

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A. INTRODUCTION

- This presentation provides brief highlights of the following:
  - Recent changes and interpretations under the *Income Tax Act* ("ITA")
  - New policies and publications from the Charities Directorate of the Canada Revenue Agency ("CRA")
  - Federal and provincial legislative issues affecting charities
  - Some of the more significant court decisions during the past year

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

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

- On November 22, 2006, Bill C-33, was introduced to address a lengthy list of proposed amendments to the ITA
- Bill C-33 amended and consolidated earlier proposed amendments released on December 20, 2002, December 5, 2003, February 27, 2004 and July 18, 2005

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- **Bill C-33 passed 3rd reading in the House of Commons and first reading in the Senate in June 2007**
- **The government then prorogued Parliament and began a new session on October 16, 2007**
- **The current Bill C-33 has "died on the order paper"**
- **Finance is interested in having the Bill passed since the proposed changes have been around since 2002**
- **At this point it is not clear what will happen to Bill C-33**

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- **Some of the more significant changes proposed involve the introduction of**
  - **Split-receipting rules**
  - **Provisions which curtail abusive donation tax shelter schemes**
  - **New definitions for charitable organizations and public foundations**
- **The provisions contained in Bill C-33 are, for the most part, the same as the amendments released in July 2005, with a few exceptions**
  - **Withdrawal of reasonable inquiry requirement for gifts over $5,000**

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- **Inter-Charity Gifts**
  - **Split-receipting rules will not apply to inter-charity transfers, so common law will continue to apply**
  - **Where there is a gift of property involving a debt, it is not clear whether the amount to be factored into the disbursement quota calculation for both the transferor and transferee charity is the fair market value of the property being gifted or the net amount after deducting the debt**

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- Non-Application of Deemed Fair Market Value Provisions
  - The deeming provisions will not apply where the donor has acquired property from a transferor (such as a spouse) on a tax-deferred rollover basis
- Although Bill C-33 has not been enacted, CRA has begun reviewing applications for charitable status and re-designation by using the new proposed definitions for charitable organization and public foundation
- The new definition replaced the "contribution test" with a "control test". Charities that do not meet this test will be designated as private foundations

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2. March 2007 Federal Budget

- On October 2, 2007, the Department of Finance released draft legislation to implement the second half of the tax measures proposed in the 2007 Budget, including those that deal with charities
- From a preliminary review of the draft legislation, it is evident that the basic framework of the legislation is generally consistent with the initiatives that were introduced in the March 2007 Budget

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- Extension of Capital Gains Exemption to Private Foundations
  - The March 2007 Budget proposes to eliminate the taxation of capital gains arising from donations of publicly-listed securities to private foundations, but not ecologically sensitive lands
  - This also applies to donations of publicly listed securities by an arms length employee who acquired the security under an option granted by the employer and which will exempt the associated employment benefit from taxation

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- **Excess Business Holdings Rules**
  - **The government was concerned that persons connected with a private foundation, by virtue of the combined shareholdings between them and the foundation's, have influence that they may use for their own benefit**
  - **The new excess business holdings rules will require a private foundation to continuously monitor its holdings and acquisitions of both publicly-listed and private corporation shares**
  - **#1 Safe harbour – 2% or less**
    - **A private foundation is permitted to hold a maximum of 2% of all outstanding shares in a particular class of shares in any one corporation**

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- **#2 Monitoring and reporting – over 2%**
  - **If a private foundation's holdings of one or more classes of shares of a company exceeds 2% of all outstanding shares of that particular class, the private foundation will be required to report to CRA the amount of shares held at the end of the year of all classes in the corporation by the foundation, as well as by non-arm's length persons**

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- **The private foundation will also be required to report to CRA any "material transactions" during the year by the foundation or non-arm's length persons for any period during which the foundation was outside the safe harbour in respect of the corporation**
- **A material transaction involves the acquisition or disposition of more than $100,000 worth of shares of a particular class or more than 0.5% of all outstanding shares of that class**

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– **#3 Divestment – over 20%**
  - **If a private foundation is outside the safe harbour range and the foundation and non-arm's length persons together hold more than 20% of the outstanding shares of a particular class of shares of a corporation, a divestment will be required**
  - **Penalties will be imposed if the divestment does not occur within the time periods specified by the rules**

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- **The length of the period within which a foundation will be required to divest itself of excess shares will depend on the manner by which the excess arose:**
  - **If the foundation purchased shares which would result in an excess at the end of the year, the foundation would be required to divest itself of the excess before the end of that year**
  - **If the excess was acquired as a result of an acquisition of shares by a non-arm's length person or by a donation to the foundation by a non-arm's length person, the foundation would be required to divest itself of the excess before the end of the subsequent taxation year**

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  - **If the excess is the result of a donation from an arm's length party or a repurchase of shares by the corporation, the foundation would be required to divest itself of the excess before the end of the 2nd subsequent taxation year**
  - **If the excess is the result of a donation by way of a bequest, the foundation would be required to divest itself of the excess before the end of the 5th subsequent taxation year**

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– **Non-arm's Length Persons**
  - **A private foundation outside the safe harbour with respect to a corporation will be required to report in respect of the holdings in that corporation of persons not dealing at arm's length with the foundation (section 251 of the *Income Tax Act*)**
  - **Such persons will include any person, or member of a related group of persons, that controls the foundation, and any person not dealing at arm's length with such a controlling person or group member**

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- **However, a person may be considered to be dealing at arm's length from the controlling person or member if the person is at least 18 years of age and living separate and apart from the controlling person or member, and the foundation applies to the Minister of National Revenue for a determination of this question of fact**
- **Reporting will not be required in respect of non-arm's length persons who hold less than $100,000 worth of shares of a particular class and less than 0.5% of all the outstanding shares of a class**

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– **Exemptions**
  - **No obligation to divest will be imposed on donations of shares made before March 19, 2007, that were made subject to a trust or direction that they be retained by the foundation, if the terms of the gift prevent the foundation from disposing of them**
  - **The same exemption applies to donations made on or after March 19, 2007 and before March 19, 2012 pursuant to the terms of a will signed or an *inter vivos* trust settled before March 19, 2007 and not amended after that date**

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- However, these shares will be taken into account in determining the application of the excess business holdings regime to other shareholdings

– Penalty

- A penalty will apply in respect of a foundation's excess business holdings that have not been divested as required
- The proposed penalty is 5% of the value of excess holdings, increasing to 10% if a second infraction occurs within 5 years

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– Transition

- Private foundations may divest, over a period of 5 to 20 years, excess business holdings existing as of March 18, 2007 at a rate of 20% every 5 years until the excess is eliminated
- To encourage private foundations with excess holdings to divest in a timely fashion, donations made to a private foundation which has not completed its transition by the end of its first taxation year beginning after March 18, 2012 will be subject to tax on any capital gains resulting from the disposition

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C. NEW POLICIES AND PUBLICATIONS FROM CANADA REVENUE AGENCY

1. New Guidelines for Applying the New Sanctions

- On April 20, 2007, CRA released guidelines for applying the new sanctions under the ITA
- The document sets out CRA's approach to the application of the new penalties and sanctions resulting from the amendments to the ITA in May 2005
- Until recently, the end product of an audit was either revocation of charitable status or the issuance of an undertaking letter requiring the charity to undertake certain corrective actions to become compliant

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- **Under the new regime, CRA will have four options to ensure compliance**
  - **Education, either general publications or a letter to a charity explaining its obligations under the ITA**
  - **A compliance agreement (similar to the undertaking letter)**
  - **Imposition of an interim sanction or penalty**
  - **Revocation of charitable status**
- **Generally, CRA will start with educational method to obtain compliance, and then move more progressively through compliance agreement, sanctions, and the ultimate sanction of revocation if necessary**

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2. CRA Warning to Charities on Tax Shelter Gifting Arrangements

- **On June 4, 2007 and August 13, 2007 the CRA issued warnings to registered charities cautioning that participating in tax shelter gifting arrangements can jeopardize charitable status or expose them to monetary penalties**
- **CRA intends to challenge and proceed with compliance actions against any arrangement that does not comply with the ITA**
- **In the August 2007 tax alert, CRA warns that it intends to audit all such arrangements**

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- **CRA has audited over 26,000 individuals who have participated in these tax shelters and about $1.4 billion in claimed donations have been denied**
- **CRA will soon complete audits of another 20,000 taxpayers, involving close to $550 million in donations**
- **CRA is about to begin auditing another 50,000 taxpayers**
- **CRA recommends that anyone considering participating in tax shelter donation arrangements obtain independent legal and tax advice**

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- **CRA also warns that the fact that investors in some of these tax shelter donation arrangements have not been reassessed should not be interpreted as the CRA's acceptance of the arrangement and that such audits may take more than one year to complete**
- **CRA's aggressive reassessments on taxpayers involved donation tax shelters and art-flips have led to a number of cases in the tax court**
- **Charities that knowingly undertake the following actions will be subject to revocation and/or significant penalties**
  - **Exploit tax receipting privileges**
  - **Fail to devote resources to legitimate charitable activities**

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D. OTHER RECENT FEDERAL AND PROVINCIAL LEGISLATION AFFECTING CHARITIES

1. New Anti-Terrorism Legislation: Bill C-25

- **Bill C-25 was introduced in October 2006 and received Royal Assent on December 14, 2006**
- **Some of the most important amendments in Bill C-25 that are applicable to charities include:**
  - **Bolster client identification, record-keeping and reporting measures**
  - **Allow the Financial Transactions and Reports Analysis Centre of Canada ("FINTRAC") to disclose additional information, to both domestic and foreign law enforcement and intelligence agencies**

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

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- **The Draft Regulations from the Department of Finance, published on June 30, 2007, if adopted, will necessitate a restructuring of legal counsel's procedures concerning advising clients on monetary transactions**
- **The Draft Regulations would have significant implications for how lawyers conduct their practice in order to implement the strict client verification, risk assessments and record keeping procedures**
- **To assist in keeping lawyers in compliance, the Federation of Law Societies of Canada has developed several model rules to be adopted and implemented by individual law societies across the country**

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2. House of Commons Subcommittee Report Recommends Major Changes to Anti-terrorism Legislation

- **The final report of the House of Commons Subcommittee on review of the *Anti-terrorism Act* was published March 27, 2007**
- **Selected recommendations for change to *Charities Registration (Security Information) Act* include the following:**
  - **Implement a "due diligence" defence for charities facing deregistration under S.4(1)(a)(b) and (c)**

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- **CRA should consult with charitable sector and develop "made in Canada "best practice" guidelines" to assist charities in their due diligence assessments**
- **Institute a *mens rea* requirement into paragraphs 4(1)(b) and (c)**
- **Right to appeal for charities from a decision that a referred certificate is reasonable**

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

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

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4. **Telemarketing and the National Do Not Call List**

- **On July 3, 2007 the Canadian Radio-Television and Telecommunication Commission (CRTC) released telecom decision CRTC #2007-48**
- **This decision established a National Do Not Call List ("NDNC") but**
  - **Charities registered under s.248(1) of the ITA have been exempted from the rules and guidelines of the NDNC list**

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- **However, with respect to individual Do Not Call lists, registered charities must continue to maintain their own lists and honour consumer requests not to be called**
- **This decision also removed a requirement, originating in a 2004 decision, that a toll free number manned during business hours must always be provided to the consumer at the beginning of a call**
  - **However, a contact number must still be provided when requested**
  - **The number must be local or toll free**

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- The number must be answered by an individual or voicemail and returned in three business days

- The requirement that the telemarketer must immediately provide identification information before any other communication and before asking for the desired individual has been replaced with the requirement that identification information be provided only after the telemarketer has reached the intended recipient of the telecommunication
- Penalties for violations can range from $1,500 to $15,000 per violation

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E. RECENT CASE LAW AFFECTING CHARITIES

Meaning of Charity and Gift

1. Provincial Amateur Sport Organizations Precluded from Attaining Charitable Status

- On May16, 2007, the Supreme Court of Canada ("SCC") heard an appeal from the Federal Court of Appeal ("FCA"), in *A.Y.S.A. Amateur Youth Soccer Association v. Canada Revenue Agency ("AYSA")*, with respect to the refusal to register the appellant as a charitable organization
- The purposes of the organization were to promote amateur youth soccer and offer youths the opportunity to develop pride in their ability and soccer skills

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- The appellant argued that since the common law in Ontario recognizes the promotion of amateur sport as a charitable purpose and the proposed activities are confined to Ontario, the law of Ontario should apply to the determination of its charitable status
- The FCA had held that there was no need to have recourse to the common law of Ontario since the ITA precludes the possibility of an amateur sports organization being registered as a charity, since the ITA only permits the separate registration of Registered Canadian Amateur Athletic Associations ("RCAAA") where they operate on a nation-wide basis
- The SCC released its decision on October 5, 2007

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- **The SCC held that just because AYSA, and other sports organizations do not qualify as a RCAAA, does not automatically preclude them from being found to be a charity at common law**
- **The RCAAA regime in the ITA is not a complete code for amateur sporting activities, and its provisions are not to be read as an exhaustive statement on the charitable status of all sports organizations in all circumstances**
- **The SCC held that sport, if ancillary to another recognized charitable purpose, such as education, can be charitable, but not sport in itself**

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- **The ITA does not support a wide expansion of its definition of charity, and so the extension of charitable status to include sports would be a matter of widespread reform better suited to Parliament than the courts**

Regulation of Charities

1. CRA Audits of Registered Charities

- **On May 10, 2007, the SCC granted leave to appeal in *Redeemer Foundation v. Minister of National Revenue***
- **This appeal is tentatively scheduled to be heard on February 28, 2008**
- **In this case, the FCA considered the process CRA must follow to obtain the names of donors during the course of an audit on a registered charity**

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- **This case involved a request for donor information which was used by the CRA to contact the donors and advise them that they would be reassessed in order to disallow the donation tax credits claimed for their donations to the charity**
- **Initially the court declared that actions of the CRA auditor to be unlawful and ordered the reassessments of the donors to be vacated**
- **On appeal the FCA overturned the initial decision on the basis that there were other provisions of the ITA authorizing the auditor to make the request he did and to use that information for subsequent tax assessments**

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2. Court Says "Place of Worship" Property Tax Exemption Should Be Strictly Construed

- **In the February 2007 decision in *Holy Theotokos Convent v. Whitchurch-Stouffville (Town)*, the Ontario Superior Court of Justice held that for public policy reasons, the exemption for "places of worship" under the *Assessment Act* (Ontario) should be strictly construed, and as such refused to exempt the entire convent property from payment of property taxes**
- **The court confirmed that the proper test to apply in determining whether an exemption applies is the "primary purpose test"**

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  - **i.e. The primary or dominant purpose for which the property is used must be exempt under the *Assessment Act* (Ontario)**
- **In denying the exemption, the court held that the exemption does not apply to the worship activities confined to solely to the devotional life of members of a religious order whether that includes group or individual worship or prayers for the convent members**
- **However, the exemption did apply to places of worship inside the convent grounds open to members of the public for some formal worship services**

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Directors' Liability and Governance

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

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

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

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

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2. Fairness, Reasonableness and Good Faith Expectations

- ***Chu v. Scarborough Hospital Corp*. is a recent Ontario Divisional Court decision released on July 6, 2007**
- **The decision involved a dispute between Lai Chu ("Chu"), an annual member of the Scarborough Hospital, and the hospital's board of directors**
- **The decision considered several provisions of the *Corporations Act* (Ontario), the statute under which many Ontario not-for-profit organizations incorporate**

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- **The hospital's governance structure, classes and terms of membership, the calling of special meetings and the interpretation of by-laws were carefully canvassed by the court**
- **In dismissing the appeal, the court quoted from the Ontario Superior Court's sound admonishment of the board of directors for having acted unfairly and not in good faith toward the hospital's membership**

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- **The Divisional Court concluded that there was no palpable and overriding error in the trial judge's decision which stated that "a board of directors of a *Corporations Act* corporation must interpret and apply its by-laws fairly, reasonably and in good faith"**
- **This decision joins a growing body of jurisprudence which indicates that non-share capital corporations must rigorously follow corporate governance procedures**
- **Fairness, reasonableness and good faith are expected at all levels of corporate life irrespective of the type of organization in question**

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