
ASSOCIATION OF TREASURERS OF RELIGIOUS INSTITUTIONS
(ATRI) 19TH ANNUAL CONFERENCE

Winnipeg – October 1, 2006

CHARITIES UPDATE 2006
SELECTED TOPICS
Update on Changes to the *Income Tax Act*
Affecting Charities

By Terrance S. Carter, B.A., LL.B.
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OVERVIEW

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2. HIGHLIGHTS OF TAX CHANGES PROPOSED ON JULY 18, 2005
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1. HIGHLIGHTS OF TAX CHANGES ENACTED BY BILL C-33 IN MAY 2005
The following is a list of changes enacted by Bill C-33 amending the *Income Tax Act* (ITA), which amendments came into effect as of May 13, 2005:
 - The 4.5% disbursement quota is reduced to 3.5%
 - The 3.5% disbursement quota is extended to charitable organizations for their taxation years that begin after March 22, 2004, except that for charitable organizations registered before March 23, 2004, the 3.5% disbursement quota applies to their taxation years that begin after 2008

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- **The 3.5% disbursement quota does not apply where the amount of investment assets is equal to or less than \$25,000**
- **Gifts transferred to charitable organizations from other registered charities are now subject to the 80% disbursement quota**
- **The 80% disbursement quota can be delayed through a transfer of “enduring property” to a charity. Enduring property includes (1) ten-year gifts, (2) five-year gifts received by a charitable organization from another registered charity, (3) gifts of life insurance proceeds, registered retirement income funds or registered retirement savings plans as a result of direct beneficiary designation, and (4) inter-charity transfers of (1) and (3) above**

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- **Inter-charity transfers have become more complicated**
- **Failure to comply with rules for registered charities under the Act can result in intermediate sanctions and penalties against charities, without their charitable status being revoked at the first instance**
- **The conferment of “undue benefit” by a charity or by another person at the direction or with the consent of the charity, on any person will lead to intermediate penalties for the charity in question**

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- 2. HIGHLIGHTS OF TAX CHANGES PROPOSED ON JULY 18, 2005**
- The following is a list of the changes proposed on July 18, 2005:**
- **New split-receipting rules will apply that would allow a donor to receive a limited advantage in respect of a gift having been made**
 - **The broad definition of “advantage” may reduce the eligible amount of a charitable receipt**
 - **Complicated new rules to curtail tax shelter schemes may result in reduction of the eligible amount on charitable receipts for gifts in-kind**

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- Where (1) donated property was acquired by the donor through a tax shelter arrangement regardless of when it was acquired, or (2) donated property was acquired by the donor less than 3 years before making the gift, the value of the donated property would be “deemed” to be the lesser of (i) the fair market value otherwise determined and (ii) the cost of the property to the donor immediately before making the gift
- Where donated property was acquired less than 10 years before making the gift, and where it is “reasonable to conclude” that one of the main reasons for acquiring the property was to make a gift to a qualified donee, the deeming provision also applies

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- The acquisition of a donated property by a person or a partnership dealing non arm’s length with the donor within the said 3-year or 10-year hold periods would also impact how the fair market value of the donated property is determined
- The requirement to make “reasonable inquiries” for gifts over \$5,000 has been eliminated
- However, charities will still need to make due diligence inquiries of donors before issuing receipts whether gifts in kind or cash, as to the existence of circumstances involving the gift

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- New definitions of charitable organizations and public foundations will apply so that the current contribution test (not more than 50% of the capital contributed to a charitable organization or public foundation can be from one donor) will be replaced by a new control test
- Will permit a charity to receive contributions of more than 50% of its capital from one person or group of persons, provided that the donor does not control the charity or is related to more than 50% of the directors and trustees of the charity retroactively to January 1, 2000
- Gifts made by a charity to a non qualified donee will become cause for revocation of the charity’s status

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3. NEW DEVELOPMENTS

Elimination of Capital Gains on Certain Gifts

- Generally, a taxpayer who disposes of property by way of gift is deemed to have received proceeds of disposition equal to the FMV of the property at that time. If the FMV exceeds its adjusted cost base, the taxpayer will realize a capital gain as a result of the disposition. For most gifts of property, 50% of the capital gain is included in income for the year and subject to tax
- In the 1997 Budget, the government reduced the inclusion rate from 50% down to 25% on capital gains arising from a gift of various types of property, including publicly traded shares, where the gift is to a qualified donee other than a private foundation

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- In the 2000 Budget, the government reduced the inclusion rate from 50% down to 25% on capital gains arising from an ecological gift to a qualified donee other than a private foundation
- In the May 2006 Federal Budget, the Conservative government completely removed the capital gains tax on publicly listed securities donated to charities and also extended this measure to gifts of ecologically sensitive land, effective immediately
- The entire amount of the donation tax credit will be available to be used against other sources of income. In effect, this means that the tax benefit arising from a gift of publicly traded securities or ecologically sensitive land would be the same as if it were a gift of cash

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- The donor should instruct their broker to transfer the shares directly to an investment account which the charity has set up with its own broker and the transfer should be carried out electronically where possible
- For purposes of valuation, CRA has accepted the closing bid price of the share on the date it is received or the mid-point between the high and the low trading prices for the day, whichever provides the best indicator of FMV
- Any policy with respect to receipt of publicly traded shares should deal with these issues, as well as consider under which circumstances the organization might refuse to accept such a gift, for example where the business or activities of the corporation conflict with objects and values of the organization

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- These changes do not presently apply to private foundations, but the government has indicated that it will consider consulting with the sector to develop some self-dealing rules to safeguard against potential conflicts of interest
- On August 3, 2006, the Ontario Ministry of Finance indicated that it would introduce legislative measures to ensure that the provincial tax treatment of donations of publicly-traded shares and ecological gifts would parallel the federal measures announced in the 2006 federal Budget and that both would be exempt from the provincial Corporate Minimum Tax (CMT)

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- Similarly, the Quebec Government confirmed that it would ensure that measures are introduced to eliminate the provincial tax on capital gains resulting from gifts of publicly-traded shares and ecological gifts
- In addition, as part of the 2006-2007 Quebec provincial budget, the Government extended similar capital gains treatment to gifts of musical instruments to educational institutions and added a new category of organizations authorized to issue provincial donations receipts: cultural or communications organizations

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Foundations Incurring Debt

- Historically, the Canada Revenue Agency (“CRA”) strictly interpreted the *Income Tax Act’s* (“ITA”) use of the phrase “debts incurred in connection with the purchase and sale of investment”
- CRA was of the view that these types of debts would only include a miscellaneous type of debt, such as brokerage fees or other incidental amounts related to the purchase or the sale of investments

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- CRA maintained that charitable foundations were prohibited from incurring debts for the purpose of purchasing investments, or for the purpose of using the loan proceeds to discharge debts which were, when incurred, permitted under the ITA
- In October 2005, CRA issued a new technical interpretation and revised its position with respect to public and private foundations incurring debt for the purpose of acquiring investment, enabling both to now do so

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- It is now acceptable for a foundation’s directors or members to give interest-free loans to the foundation to enable the foundation to “acquire investments, pay current operating expenses or expend on charitable activities”
- CRA explained that:
 - The borrowed money would increase the investment capital and therefore would give rise to a disbursement quota requirement;
 - The lender would not be entitled to a charitable donation tax credit if the loan is repaid by the foundation; and

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- If the lender forgives all or part of the debt, then the lender would be entitled to a charitable donation tax credit for the part of the debt that is forgiven at the time when the debt is forgiven
- However, CRA indicated that they would continue to review debt arrangements, especially those involving non arm’s length parties, in order to ensure that there are no other issues, such as personal benefit
- For more information see CRA Technical Interpretation 2005-0154751I7 at www.cra-arc.gc.ca

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Donation Tax Shelter Valuations

- As a result of the Federal Court of Appeal (“FCA”) decisions in *Nash and Klotz*, registered charities and donors should be wary of the valuations provided by promoters of donation tax shelters
- *Nash* decision coincided with CRA’s November 2005 *Taxpayer Alert* reminding potential investors to exercise caution with respect to certain donation arrangements, such as: (1) gifting trust arrangements; (2) leveraged cash donations; and (3) buy-low donate-high arrangements
- Tax advisors are advised that a tax claim supported by an independent appraisal does not automatically mean that it will not have to be defended before the CRA and the courts

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CRA Provides Sample Donation Receipts

- On October 19, 2005, CRA released four sample official donation receipts as a guide to charities. Although receipts issued by charities do not need to appear exactly as presented in the samples, the receipts must contain all relevant information set out in the sample receipts
- The four samples are for:
 - Cash gift with no advantage
 - Cash gift with advantage
 - Non-cash gift with no advantage
 - Non-cash gift with advantage

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Registering a Charity: Meeting the Public Benefit Test

- CRA released their official guidelines in March 2006, which are intended to clarify the meaning of the term "public benefit" as CRA understands it and how it would apply when CRA makes determinations of charitable status under the *Income Tax Act*
- Under current law, an organization is only charitable if it meets the definition of charity at common law
- Part of that definition requires that in order for an organization to be considered charitable it must be established for public benefit

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- **The broader public benefit test, which is the subject matter of these guidelines, is principally related to the question of “who” will benefit**
 - **Certain classes of persons are those who need a particular service within a certain geographical boundary**
 - **Whether a class of eligible beneficiaries is a sufficient segment is determined with respect to the charitable purpose proposed**
 - **Organizations which confer a private benefit are not considered charitable**

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- **A restricted service or program will generally offend the public benefit test unless it can be demonstrated that it is achieving its charitable purpose**
- **The potential number of beneficiaries is important and should not be numerically negligible, but a limited number may still meet the public benefit test**

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CRA’s New Re-Registration Process

- **Charities that fail to file their annual T3010 Information Return are subject to de-registration and a \$500 penalty to re-register**
- **CRA has set out a new re-registration process covering three different situations, depending on the charity’s taxation year and when it received the Notice of Intent to Revoke**

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Revised Forms

- The revised *Registered Charities: Application for Re-Designation* (form T2095) and the revised *Registered Charities: Application to Reduce Disbursement Quota* (form T2094) are now available at the CRA website

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