

CHARITY & THE LAW UPDATE

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*Updating Charities and Not-for-Profit Organizations on recent legal
Developments and risk management considerations*

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EDITORS NOTE

Charity & The Law Update is published without charge for distribution to charities and not-for-profit organizations across Canada and internationally. It is published approximately 3 times a year as legal developments occur. The format is designed to provide a combination of brief summaries of important developments as well as feature commentaries. Where a more lengthy article is available on a particular topic, copies can be obtained from our website at www.charitylaw.ca. The information and articles contained in this *Charity & The Law Update* are for information purposes only and do not constitute legal advice and readers are therefore advised to seek legal counsel for specific advice as required.

1. THE Y2K PROBLEM: AVOIDING LEGAL LIABILITY FOR CHARITIES

BY: TERRANCE S. CARTER

Acknowledgment: Portions of the following summary have been excerpted with permission from the Canadian Bar Association in its publication "Countdown to 2000-the Legal Issues".

A. WHAT ARE THE BASIC Y2K ISSUES FOR CHARITIES?

1. WHAT IS THE Y2K PROBLEM AND "MILLENNIUM BUG"?

· Like it or not, the Year 2000 ("Y2K") Problem or the "Millennium Bug" is difficult to ignore

- Due diligence requires that charities become aware of the issues and take precautions
- The Y2K Problem refers to the inability of computers, software and micro-processors to process date related information beyond December 31st, 1999
- The Y2K Problem originates from using abbreviated date codes and allowing for only the last two digits of the year instead of all four
- When the year changes from 1999 to 2000, technology using two digits will see a change from 99 to 00 and programs may misinterpret 00 as 1900 instead of 2000
- The Y2K is also a leap year which many computer applications may fail to consider
- If systems are not rendered capable of dealing with Y2K, they may crash or fail to correctly compute information
- The U.S. Government estimates that its Y2K costs alone to be thirty billion (\$30,000,000,000.00) (U.S.) to achieve compliance
- Considerable litigation is speculated to result, but no one knows for sure whether Y2K is more "hype" than "crisis"
- Do not panic but be aware and be prepared

2. WHAT DOES Y2K COMPLIANCE MEAN?

- A single definition of Y2K Compliance does not exist
- Compliance should include accurate and timely processing of date data using both single century and multi century formulas

- Compliance should include years 1999, 2000 and leap year calculations and recognition
- Compliance should include date and data communication and transfer capability
- Compliance should include the absence of malfunctions, logical or mathematical inconsistencies, or operational interruptions due to any data

B. HOW THE Y2K PROBLEM MAY IMPACT CHARITIES

1. COMPLIANCE DEFICIENCIES

- Failure to maintain records for Revenue Canada under the Income Tax Act and under the Charities Accounting Act (Ontario) for charities
- Inability to maintain financial statements for audit purposes
- Failure to maintain investment records
- Failure to maintain records of activities through third parties, ie, agents, co-joint venture participants, or partners

2. HARDWARE DEFICIENCIES

- Computers have internal clocks that record the time and date
- Both older models and some newer model computers still record the years with two digits
- Some computers can be corrected by a change to the basic input/output system (BIOS)
- Some computers may be too old to be fixed and will need to be replaced

3. SOFTWARE DEFICIENCIES

- Many computer software may not work properly after the Year 2000
- Vendors should be contacted to see if the software program can be updated to correct Y2K deficiencies before the Year 2000
- "Detonation method" of testing for Y2K compliance by setting the computers clock to January 1st, 2000 might result in software programs shutting down, software licenses expiring, and date reminders disappearing
- Accounts payable/receivable and payroll software may not properly work
- Records retention and retrieval system software may not properly work

4. DATA STORAGE DEFICIENCIES

- Data storage using a two digit format will not work properly after the Year 2000
- Software is generally available to update data handling programs but is not fool proof

5. TELECOMMUNICATION DEFICIENCIES

- Telephone switching equipment and voicemail may not work properly after the Year 2000
- Need to check with manufacturer about the Y2K compliance of equipment

6. ENVIRONMENTAL SYSTEM DEFICIENCIES

- Vaults, security and safety systems, sprinkler systems, HVAC, and lighting may not properly function after the Year 2000

C. THE BROADER IMPLICATIONS OF THE Y2K PROBLEM FOR CHARITIES

1. OPERATIONAL ISSUES FOR CHARITIES

- Y2K compliance by third parties
 - consider what steps should be taken to determine the Y2K compliance status of third parties, such as suppliers or other charities involved in joint projects
- Y2K representations and commitment to third parties
 - consider what Y2K representations and commitments, if any, should be provided to third parties or to donors about operations
- Disclosure obligations and financial statements
 - consider what disclosure of Y2K compliance, if any, should be made in the financial statements of the charity
- Insurance coverage
 - consider the extent to which Y2K risks can be insured under an existing policy, if at all, and what steps should be taken to protect against or extend coverage
- Risk management
 - consider whether steps should be taken to appoint an appropriate Y2K project management team to address the risks
- Staffing and personal
 - consider the implications of the Y2K Problem on staffing and labour relations
- Expert assistance

- consider whether to seek advice from outside consultants and advisors
- Delegation of the Y2K duties
- consider to what extent the board of director's responsibility to deal with Y2K Problems can be delegated to a committee of the board or to outside advisors

2. CONTRACTUAL RIGHTS AND OBLIGATIONS

- Who owns the affected software?
- consider whether the charity owns the software it uses or has licences for
- Access to software source codes
- consider who can modify a source code for customized software
- Is software warranted to be Y2K compliant?
- consider whether existing software licence agreement, maintenance support agreements and out source agreements contain a warranty stating that the software is Y2K compliant or, if not, will be modified as necessary
- Does the charity have contractual rights to modify software itself?

3. MAINTENANCE OF RELIABLE RECORDS FOR EVIDENTIARY PURPOSES

- Will a Y2K Problem compromise the integrity of the records of an charity to an extent that will render those records inadmissible in evidence in future litigation?
- Charities should consider the extent to which its inability to defend against or prosecute civil claims may occur because of a lack of a reliable evidentiary source

- Protection of privilege and confidentiality
- consider what steps should be taken to ensure that the confidentiality and privilege of Y2K information is preserved
- it may be advisable to use legal counsel to protect Y2K reports with a solicitor client privilege
- for licensed software, consider whether the software license precludes modifications without the prior consent of the software vendor
- Is software vendor offering assistance?
- consider whether the software vendor is offering assistance to make the software Y2K compliant and what warranties are being offered in this regard
- Insurance contracts
- consider whether a charity's insurance may cover the cost of determining a major Y2K Problem under an existing insurance policy
- Protection of outstanding loans
- if the charity has loaned money then consider how it can protect its rights and security if the borrower is likely to face significant risks associated with Y2K

D. WHAT IS THE EXPOSURE TO LEGAL LIABILITY FROM Y2K?

1. STATUTORY SOURCE OF LIABILITY

- Consider the statutory requirements that may be breached by lack of Y2K compliance
- ie, Income Tax Act and electronic record keeping requirements

2. PRIVATE ORGANIZATIONAL LIABILITY

- Consider whether a charity is subject to obligations and duties as members of a national or international association that may be impacted by Y2K non-compliance
- ie, failure to produce regular financial statements and reporting requirements to a national or international association

3. CONTRACTUAL LIABILITY

- Consider what contractual obligations may be affected by Y2K Problems
- i.e., direct or implied contracts to provide goods or services, technology, or equipment
- Charities should identify the specific contracts and issues that may result in liability

4. INTELLECTUAL PROPERTY LIABILITY

- Consider whether remedial action undertaken to achieve Y2K compliance may infringe, breach, contravene or misappropriate intellectual property rights of others
- ie, the Copyright Act will generally require the consent of software owners

5. CONFIDENTIALITY LIABILITY

- Consider whether technology and software data that is subject to confidentiality obligations will be impacted by Y2K Problems or Y2K Corrections
- Consider whether the disclosure of, or failure to adequately protect information constitutes a breach of privacy rights, ie, failure to protect donor lists

6. DIRECTOR AND OFFICER'S LIABILITY

- Directors and officers may be exposed to personal liability for failure to exercise due diligence in undertaking remedial steps to avoid Y2K Problems
- Directors and officers may be accountable for breach of fiduciary duties in not protecting the charity
- Directors and officers may be exposed to breach of trust for improper investment if the income or the investment is lost through Y2K Problems

7. TORT LIABILITY (ie, Civil Wrongs)

- Negligence claims may result from damages caused by Y2K problems, ie, damages that were foreseeable
- Claims based on negligent misrepresentation may be brought against manufacturers of hardware and software as well as service providers for misstatements about Y2K compliance
- Umbrella charities maybe liable for failure to warn member charities about potential Y2K Problems based on detrimental relevance

8. PUBLIC POLICY AND GOVERNMENT LIABILITY

- Municipal, provincial and federal governments may face liability as a result of their Public duty to promote and protect the public interest arising from Y2K Problems
- infrastructure systems such as transportation, telecommunications, utilities, etc.

- government services to individual clients, such as income distribution, licensing, etc.

- regulatory obligations, such as audits, inspections, commission, etc.

E. LIMITATIONS ON LEGAL REMEDIES AVAILABLE FOR Y2K PROBLEMS

1. ARE LEGAL REMEDIES PRACTICAL?

· Determine if a legal action claim will be sufficient to protect an injured party

· Serious consideration must be given to whether defendants to an action will be capable of paying the damages and whether the defendants will even exist in the future

· Legal remedies may not always be practical

2. RESTRICTION ON DAMAGES

· Do existing contracts contain restrictions on the amount of damages that can be received for losses caused by Y2K Problems?

3. REMEDIES OTHER THAN DAMAGES

· If damages are not an appropriate remedy, what other options are available to an injured party?

· A party may require immediate relief rather than waiting for prolonged litigation

· Does the injured party have the right to compel a potential defendant to fix Y2K Problems, ie, through an injunction?

4. MITIGATION OF DAMAGES

· Does an injured party have an obligation to mitigate against damages from Y2K Problems?

5. DISCLOSURE OF Y2K PROBLEM

· Must a charity disclose its knowledge of a Y2K Problem to an opposite party when the Y2K problem may impact the other party?

6. APPLICABLE LIMITATION PERIOD

· Do limitation periods and/or other considerations restrict how or by when a legal action can be commenced?

7. ARE THERE LIMITATIONS ON LEGAL LIABILITY

· Contracts may contain specific provisions limiting liability and establishing conditions that must be met before liability can be found

· Contracts may also contain certain time limitations in its representations or warranties

· Contracts may also contain waivers and estoppel that preclude liability claims

F. REDUCING EXPOSURE TO LEGAL LIABILITIES

1. MINIMUM STEPS THAT SHOULD BE TAKEN

· Appoint someone on the staff or the board of the charity to take charge of Y2K compliance

- List all hardware, software and automated/electronic equipment used in operations
- Assess compliance of equipment and systems and get help from a consultant
- Retain qualified consultants or advisors as necessary
- Identify most critical functions in order to prioritize and budget for action
- Repair, upgrade and change systems and procedures according to priorities
- Require information from third party providers about their system compliance through written confirmation Y2K compliance letters and checklists as necessary
- Test thoroughly for compliance with respect to all Y2K issues
- Maintain separate electronic or paper backup of records, data basis and key dates
- Develop a contingency plan for the most critical functions of a charity
- Review insurance contracts, particularly liability coverage, to see if there is any protection available under insurance coverage
- Review the fine print in all contracts to determine exposure to Y2K liability and possible renegotiate contracts if necessary
- Maintain documentation that demonstrate that "reasonable care" and "due diligence" was taken by the charity to protect its assets and to continue to provide required services
- Avoid potentially incriminating correspondence about Y2K Problems, including e-mail

- Ensure that employees are informed of both Y2K Problems and what remedial steps are being taken to deal with the problem
- Ensure a consistent approach is taken to deal with the Y2K Problem and do not panic

2. WHAT DIRECTORS AND OFFICERS CAN DO TO PROTECT THEMSELVES

- Exercise due diligence, which involves discharging duties and responsibilities with the requisite degree of care, diligence and skill required by statute and at common law
- Obtain indemnification from the charity for the directors and officers with respect to potential Y2K liability
- Obtaining liability insurance for directors and officers, if available, for Y2K liability

3. SPECIAL PROBLEMS INVOLVING AMALGAMATIONS AND MERGERS

- Due diligence involving mergers and/or amalgamation with other charities require that careful consideration be given to Y2K compliance by each of the amalgamating charities
- Liabilities associated with the Y2K Problem by an amalgamated charity will become the liability problem of the amalgamating charity

4. DUE DILIGENCE REQUIRED WITH JOINT PROJECTS WITH OTHER CHARITIES

- Y2K liability exposure of agents, co-joint venture participants, or partners of an charity will potentially impact the liability of the charity

- Potential for liability exposure will often occur in relation to international charitable activities

- Need to conduct due diligence compliance of Y2K Problems of other charities

5. CONTRACTING TO CORRECT Y2K PROBLEM

- Define Y2K services and the service provider's obligations

- clearly describe the scope of the work and the resulting services to be provided

- Define Y2K Compliance

- clearly define what is meant by Y2K Compliance

- Define project management

- clearly describe the manner in which the Y2K project is to be managed

- Define alternative dispute resolution mechanics

- the contract should provide for the use of alternative dispute resolution mechanism

- Consents to modify intellectual property rights

- consider what consents are required for the service provider to modify the software

- Ownership of modifications

- the contract should specify the ownership of the modifications and provide for appropriate waivers of "moral" rights

- Protecting confidentiality

- the contract should provide appropriate protection for confidential information

- Representations and warranties

- representations and warranties should be used to identify risk associated with the performance of the contract

- Limitation of liability

- limitations of liability should reflect the economics of allocating risks

- Indemnification of charities

- when should each party have an obligation to defend and indemnify the other party?

G. WEB RESOURCE MATERIALS ON Y2K ISSUES

Year 2000: Sharing CEO Perspectives
Viewpoint

and Executive Summary

<http://www.conferenceboard.ca>

<http://strategis.ic.gc.ca/sos2000>

Guidance for Directors-The Millennium Bug
Year 2000: Risk Management and

<http://www.cica.ca> Contingency Planning

<http://strategis.ic.gc.ca/sos2000>

Guidance material from ITAC Year 2000:
Technology Checklist for

<http://www.itac.ca> Small Business

<http://www.cfib.ca>

January 1, 2000: Crisis or Opportunity Year
2000 legal issues

<http://www.conferenceboard.ca>

<http://www.cba.org/abc>

2. *IS THE SKY REALLY FALLING? REVENUE CANADA'S POSITION ON DONOR BENEFITS AND*

RELIGIOUS CHARITIES

BY: CARL JUNEAU, ASSISTANT DIRECTOR,
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The following is the full text of a speech given by Carl Juneau, Assistant Director, Charities Division, Revenue Canada, at the Annual 1999 Church & the Law Seminar held on February 3rd, 1999 for approximately 500 ministers and religious leaders on the topic of what are permissible benefits to donors, with particular emphasis concerning religious charities. The comments in the speech, though, also have general application to charities in understanding what are reasonable limits to donor benefits with regard to gifts and receiving donations. For information on the background to the speech by Carl Juneau, see *Charity & the Law Update*, Vol. 1, No. 2 dated January 21st, 1999 at page 1, available at www.charitylaw.ca

A. INTRODUCTION

"My topic today deals with gifts to charities and any benefits that go back to the donor as a result of the gift. As an introduction, I'd like to say two words: Alexei Yashin.

Obviously, I can't talk about Alexei Yashin because of the confidentiality provisions in the Income Tax Act. There are probably some aspects to the Yashin incident that the media might not know, and I'm not implying that Mr. Yashin was right or wrong in the case, or that there is an absolute comparison between Mr. Yashin and any other donor. But what's useful here is that I know you've been reading the papers or

watching the news on TV, and I know that you have a sense of the range of the public reaction to the incident. And it is this public reaction that I want you to think about.

The public reaction gives us an idea of the problems that can arise with gifts and tax-receipting, and shows that the problems may not be – contrary to what some people believe - entirely Revenue Canada's doing. There is at least a generally accepted notion of fairness present here, in terms of how and why people should give.

The notion of a gift for tax purposes is defined at law. Generally speaking, a gift is a voluntary transfer of property without consideration. It is perhaps clichéd to say that law is a blunt instrument – but it's fairly true, and a law has to be applied to the facts of particular cases.

But the problem is also with some people who see the law, less as a normative guide to human behaviour, and more as an obstacle to be circumvented. Make your legal trail convoluted enough, they think, and chances are the law will not find you – maybe.

As Sir Thomas More once said, some people will suggest: "We're different. We're good. Don't apply the law to us." But we need to apply the law evenly, to get at the Devil. If we cast the law aside, what will we do, ladies and gentlemen, when the Devil turns on us? Behind which law will we hide? We will say to the Devil, "Yes, but there's the law." And the Devil will say "What law?"

I am here to assist people who have a genuine desire to help their neighbours by giving, and who need to deal with the

bluntness of the law. In so doing, I'd like to try and answer a few questions.

Over the course of the past year especially, the Canadian Council of Christian Charities has publicly expressed the concern that Revenue Canada was "out to get Christian charities". It raised a number of issues, some of which I propose to address here, and, reacting to what it felt was a legitimate perception, it sought to raise public awareness about the issues through the media - notably through its own newsletter

B. IS REVENUE CANADA SINGLING OUT RELIGIOUS CHARITIES?

One general message that seemed to pervade the debate is that Revenue Canada had singled out Christian charities for particular grief.

I would be foolish to deny that we were indeed auditing several religious organizations. But here are a few statistics: In September of 1998, there were in Canada 76,426 registered charities. Of those, 31,366 organizations, or approximately 41% were religious charities. In the circumstances, it is only fair and logical that a substantial portion of our audits should be directed toward religious charities.

As well, certain types of charities have ways of operating that are different from other charities - and it is understandable that when we choose a particular charity for audit, we are most interested in those aspects of the charity's operations where experience tells us we have found significant abuse in the past. This is a matter of efficiency. If we did audits purely at random, without any audit leads whatsoever, this would significantly reduce the effectiveness of our audit program and result in a proportionate increase in non-compliance.

and through Christian Week. I also received a couple of calls from more mainstream publications - notably from the Victoria Times Colonist, who had apparently received a package of selected information from Christian Week.

I am not trying to impugn the intentions of the CCCC or of those people who worry about Revenue Canada - I think most of us do at one time or another. But it is certainly appropriate to try and get more perspective on the issue of gifting and donor benefits.

We know for instance that certain charities are more likely to participate in art donation scams. These are scams where for example the donor purchases a painting at a bargain price, and gives it to a registered charity, usually in exchange for a tax receipt that reflects a highly inflated market value. As it happens, organizations involved in art donation scams aren't usually religious charities. Just so I don't get quoted out of context by some reporter, art donation scams are not rampant but they do occur; they can involve significant amounts of money; in the aggregate, they do involve a lot of money; and they have a significant impact on the affected charity, on the donor's taxes and on resulting state revenues. So for the sake of a sound tax administration, we need to track them down. Are we singling out charities that are likely to issue inflated receipts for donations of art? You bet we are. But is it because we hold a grudge against the type of charity they happen to be, or the art they happen to like? Certainly not.

So it is not because charities are Christian, or because they deal with the environment, or because they send funds abroad that we audit. It is because our role is to see that people comply with the tax law.

C. IS THERE A MOVE AFOOT WITHIN GOVERNMENT TO WITHDRAW THE TAX PRIVILEGES AVAILABLE TO RELIGIOUS CHARITIES?

No, absolutely not. I should add that if a move comes to remove religious organizations from the charitable sector, the impetus will not come from Revenue Canada, it will come from elsewhere.

You should know for instance that the whole legal definition of charity and the tax incentives that go with it are up for discussion at the moment, in the context of reports submitted to government by the Broadbent Panel and by the Kahanoff Foundation in particular.

But as late as last Fall, I broached the question of hiving off religious charities from the rest of the charitable sector, with Department of Finance officials, wanting to find out where the ugly rumour concerning religious organizations got started. And the Finance position at the time was that hiving off religious organizations from the rest of the sector was completely out of the question. The particular Finance official was as perplexed as I was as to the origins of this rumour. I since suspect that the suggestion is coming from other areas of the sector – and Terry Carter can corroborate this.

D. DIRECTED DONATIONS, DONOR BENEFIT, AND DETACHED AND DISINTERESTED GENEROSITY

I would like to talk about the notion of directing donations through charities to particular individuals, and the whole idea

that a charitable gift has to be made out of detached and disinterested generosity.

Revenue Canada has an Interpretation Bulletin – IT-110R – that talks about charitable gifts . In particular, paragraph 15(f) of the Bulletin formerly read: .

"Gifts directed to a person designated by a donor: A charity may not issue an official receipt for income tax purposes if the donor has directed the charity to give the funds to a specified person or family as opposed to a program. In reality, such a gift is made to the person or family and not to the charity. Donations made to charities can be subject to a general direction but decisions regarding specific beneficiaries of one of its established programs must be the exclusive responsibility of the charity".

Since June 1997, paragraph 15(f) of the Bulletin now reads:

"A charity may not issue an official receipt for income tax purposes if the donor has directed the charity to give the funds to a specified person or family. In reality, such a gift is made to the person or family and not to the charity. However, donation subject to a general direction from the donor that the gift be used in a particular program operated by the charity are acceptable, provided that no benefit accrues to the donor, the directed gift does not benefit any person not dealing at arms' length with the donor, and decisions regarding utilization of the donation within a program rest with the charity".

The wording has changed, not because Revenue Canada claims the law has changed, but because we felt we had to be more careful: some people were taking the wording of paragraph 15(f) – especially that part that deals with the organization's decisions about beneficiaries, and pushing it beyond its intended limits.

Revenue Canada's intention was to get at tax abusers. We are the first to recognize that the proper characterization of a gift will often turn on the facts of a given case, and that there are circumstances in which charitable gifts can ultimately benefit certain individuals. However these are gifts that ought to be made for the organization, within the organization's purposes, with the organization's approval and control, and for the organization's own purposes rather than for personal and private advantage.

I will return to the wording of the IT Bulletin in a moment.

E. DETACHED AND DISINTERESTED GENEROSITY

Closely related to this wording is the use of the phrase "detached and disinterested generosity" when explaining how a valid gift should be made. The concern expressed by some arises from the use of the phrase in recent and more or less routine Revenue Canada correspondence dealing with gifts, and stating that a gift has to be made from "detached and disinterested generosity".

This expression has been used by Revenue Canada for quite some time, but it has been used more and more frequently in past years, mainly because we are increasingly concerned that certain charities and donors are using ingenious interpretations of the legal concept of gifting to defeat the intent and the letter of the law, and obtain tax benefits where none should be had. This problem is not unique to a single organization or group of organizations. It shows up in different areas of the sector under different guises. With private foundations, it used to show up in the form of loan-backs, until last year's legislation on non-qualifying securities. With athletic

associations, it shows up in the form of coaching sessions for little Johnny.

It is suggested, mostly by the Canadian Council of Christian Charities, that the concept of detached and disinterested generosity is new, that it is a concept imported wholesale from Australian law, that it has been arbitrarily imported by Revenue Canada, and that it is not an accurate statement of Canadian law.

In point of fact, the concept originally comes from British common law, of which both Canadian and Australian common law are direct descendants. Notably, in 1896, Lord MacNaghten – the very same one who gave us the now-famous four categories of charitable purposes - dealt with the case of an art union, which gave its subscribers an engraving of a work of

art and a chance to win an artwork in the form of a prize . Lord MacNaghten did not view the subscribers' contributions in that case as gifts, and in deciding so, he commented on the concept of an "annual voluntary contribution". He wrote:

"Apart from authority, the meaning of the provision would seem to be tolerably obvious. The first observation that must, I think, occur to any one who may be called upon to construe it is that the phrase which the Legislature has adopted is an old and familiar acquaintance. In the public streets it meets the eye not infrequently (sic) on the walls of schools and hospitals; it is to be found in the forefront of many charitable appeals. So used, [the concept of annual voluntary contribution] carries with it a meaning which nobody can mistake. It means that the institution on whose behalf the statement is put forward depends for its support on freewill offerings - on the generosity of persons acting from disinterested motives, and not looking for

any return in the shape of direct personal advantage".

What is detached and disinterested generosity? The concept is intertwined with, and overlaps the policy on directed donations that is set out in the Interpretation Bulletin mentioned above. This is so, because it has to be interpreted in the proper context, not out of context.

The concept of detached and disinterested generosity was indeed referred to in some recent Australian cases, *Commissioner of Taxation v. McPhail*, and *Leary v. Federal Commissioner of Taxation*. And Canadian courts who viewed the notion as applying equally in Canadian common law, liked the reasoning set out in the Australian cases, and they referred to the cases. To constitute a gift,

"...it must appear that the property transferred was transferred voluntarily and not as the result of a contractual obligation to transfer it and that no advantage of a material character was received by the transferor by way of return".

The Court of Appeal in the *Leary* case went on to qualify the above statement by saying that a contractually binding promise to make a gift does not deprive it of its character. Similarly, the fact that a donor receives some return from a charity does not prove conclusively that there was no gift. Nevertheless, and in anticipation of those who would want to take this latter proposition to the limit, this does not mean that a charity can provide a valuable return to the donor in any and all circumstances. The Court went on to say:

"(T)he above-mentioned considerations indicate usual attributes of a gift, namely, that a gift will ordinarily be by way of benefaction, that a gift will usually be not made in pursuance of a contractual

obligation and that a gift will ordinarily be without any advantage of a material character being received in return. I would add to those usual attributes of a gift, the attribute that a gift ordinarily proceeds from a detached and disinterested generosity, out of affection, respect, admiration, charity or like impulses".

The notion of detached and disinterested generosity has been cited more and more frequently with approval by Canadian courts. Because it is cited by the courts, it is without question part of Canadian law – common law (like the definition of a gift), not statute law.

Some people are concerned that if a gift has to be made out of detached and disinterested generosity, it will effectively shut down every conceivable form of giving, since in a pure psychological sense, no one can be absolutely "detached or disinterested" about giving.

The use of the concept of detached and disinterested generosity by the courts, and accordingly by Revenue Canada, is perhaps infelicitous, but it was intended to foil those people who would use charitable giving and the ensuing tax benefits to suit private and personal purposes, and who would interpret the usual, more terse definition of a "gift" narrowly or broadly, as the circumstances and their private purposes dictated.

Not to be thwarted by the courts' attempts, Wim Posthumus writes in an opinion piece in the November 98 issue of the *Christian Courier*, some organizations have gone on to give the words "detached and disinterested generosity" a wider emancipation than intended in the context. "This wider meaning they have attributed to Revenue Canada as its new definition of charitable giving. The result has been to frighten and inflame the Christian community sufficiently to encourage it to contribute to a

legal trust fund". With all due respect to the organizations involved, to quote the phrase "detached and disinterested generosity" out of the context of the cases in which it is being applied is a gross misinterpretation. And what I'd like to do is provide you with some guidelines.

Again, a gift at law is a voluntary transfer of property without consideration. The consideration, if any, is the advantage that a "donor" derives.

This consideration or this advantage are much more than something which is measurable in economic terms. A "material" advantage - which is a term often used synonymously for "consideration" - is much more than an economic advantage. Material here is used in the sense of the existence of a direct and significant benefit accruing specifically back to the donor or to a person designated by the donor, (that designation being made purely because of private and personal reasons not related to the charitable purpose at hand).

Designating funds to a specific project of a charity is acceptable. The donor here may be interested in the project, but it is an interest in the sense of a curiosity, a concern, a personal identification with the goals of the project. But contrary to what some people may suggest, a donation to a specific project is still dis-interested insofar as the donor's support is not primarily or substantially motivated by private and personal advantage. "Interest" - in this latter, unacceptable sense - is more akin to the right to have an advantage accruing from the donation. The advantage to the donor would logically be something he or she would like to get for himself or herself, or for another person for purely personal and private reasons.

The tax advantage which is received from gifts is not normally considered a 'benefit'

within this definition. Again, like the notion of detached and disinterested generosity, if we considered the tax incentive to be a benefit, the law would turn it into an absurdity .

If an individual is afflicted with a particular disease, can that individual donate to a charity dedicated to eradicating that disease? Usually. But if the payment is made on the understanding that the "donor" will receive admission to a particular treatment centre, no.

Can an alumnus of a college or university make a donation to his or her alma mater? - Usually. But if the payment gives the alumnus' children the right to use the physical recreation facilities at the university, no.

Can members of cultural charities such as a symphony, a theatre or a museum, donate to such a charity when they attend the performances or exhibitions of that charity? Yes, they can, notably within the parameters set out in Interpretation Bulletin IT-110R3, Gifts and Official Donation Receipts. Can they get a discount at the gallery gift shop, a parking pass during the year, a dinner with the curator, as well as a tax receipt? No.

According to the courts, a Christian education of one's children is a material benefit and one which carries economic and material consequences . This is an altogether different situation than making a general contribution to the Sunday School program or other church program. Note however Revenue Canada's policy regarding the partial receipting of tuition fees. This is an administrative policy which goes well beyond the law .

Does an expectation that each member pay according to his or her means automatically make that payment a gift? Not necessarily. The fact that a payment is voluntary and not

made pursuant to a specific contractual or legal obligation is irrelevant in determining whether it is a gift .

Will an employee of a charity be unable to make gifts to the charity that employs them? If it is a genuine, altruistic gift, there should be no problem. On the other hand, if it is - for instance - a condition of employment, or if it is given to flow money given to staff in Christmas bonuses back to the company, thereby allowing staff to at least claim a tax credit while keeping the company in the black, then the donors are not acting out of disinterest. In the first instance, they want a job, and in the second one, they are interested possibly in keeping their jobs, in getting a promotion, in keeping the company in the black, or in only getting a tax credit .

How about travel and living expenses? Does this not contravene the concept of detached and disinterested generosity? No. It is not the fact that you contribute at the same time as you volunteer that is damning. It is whether, for instance, you contribute to cover the cost of personal and discretionary expenses, as opposed to contributing to the organization to cover necessary costs related to the charitable project at hand.

In tax law, form matters. If it were not so, Revenue Canada and the courts would be engaged in endless exercises to determine the true intentions behind certain transactions. This is why Revenue Canada reacts to certain signs that tend to indicate whether we are in presence of a gift or not. These signs are not always absolute. They tend to establish a presumption which becomes stronger as the facts accumulate. On the donor's part, evidence of intention may be used on occasion to clarify dealings, but as the court suggested in the Friedberg case, this is not always determinative. While intention plays an important role – notably the donor's intention to grow poorer overall,

as a result of giving - after-the-fact evidence of a charitable intention is rarely successful in altering documentary evidence which clearly point in another direction .

Whether a payment is a gift would notably depend on a reasonable person, taking all the facts and circumstances of a particular case into account, could conclude

- whether or not the payment was made pursuant to an express or implied plan to convert inadmissible personal costs or

advantages into tax-assisted gifts, or

- whether or not the receipt of a benefit was dependent on the payment being made.

In deciding whether a payment is a gift, a single factor may not be determinative, but the growing presence of a combination of factors like the following will create a presumption that a payment is a gift or not.

Here are some indicia that would suggest a payment is not a gift:

- The donor specifies the beneficiary of gift, and the beneficiary is non-arm's length to the donor.

- Most donors in a program specify a beneficiary, and in most cases the beneficiary is non-arm's length to the donor.

- The beneficiary is non-arm's length to the donor and is being preferred as a result of the payment, to others equally eligible

for assistance.

- The donor gives, or donated amounts increase only when a non-arm's length beneficiary is benefiting from the program

and end or drop off substantially when the beneficiary leaves the program.

- Fund-raising solicitations or other documents stipulate that benefits to donor or to a person connected to the donor are

conditional on the making of a gift.

- A gift is ear-marked for the direct benefit of a particular individual.

- There is a contract under which a person agrees to make a gift, but which contains provisions ensuring that the gift or some

other benefit will flow to a relative.

- The donation is part of a broader agreement with the charity, involving payments for goods or services.

- There is a plan allowing participants to either make gifts, or pay (e.g., tuition)

- Donated amounts are high and identical from one donor to the next .

- There is an otherwise unexplained denial of admission or re-admission of people who are financially able, but who do not

contribute.

- In those cases where people are normally charged for services, there is a substantial gifting program but very little in the

way of a significant charge.

- Donors receive substantial or unusual pressure to contribute.

- Other factors suggesting that a gifting policy has been created as a means of avoiding the characterisation of payments as

fees in return for services and materials.

If a combination of such factors is not present, a payment could be a valid gift. Here are some indicia that suggest the payment is a gift. Again, they are not

necessarily conclusive, but must be looked at in context:

- The funds are given to the organization, for the organization's purposes and projects only.

- The funds are given at the donor's own initiative, without any solicitation by the organization or other express or implied

request.

- The organization has full discretion and control over the funds, and applies the funds for qualified expenses only . The

particular use of the funds is not under the control of, say, the recipient missionaries. The key test is that the charity has

full control over the funds so that it, and it only, can determine how it will carry out its charitable purposes. By itself alone,

the fact that a missionary receives money from a fund to which a parent has contributed is not sufficient to disqualify the

parent's payment as a gift .

- The donor does not stipulate in any way to whom the funds should be directed.

- Beneficiaries are selected by the charity according to objective criteria, and completely independently from the donor.

- The donors have had a pattern of constant and significant giving to a particular program over the years, regardless of their

involvement or that of close relatives.

- Money goes into a common pool, from which all beneficiaries receive equal support.

· The organization has objective rules governing the selection of beneficiaries and limiting the expenses that will be paid out

of the common pool.

F. CONCLUSION

Do not think for an instant that Revenue Canada is not sympathetic to the work of religious charities. At almost half the sector, religious charities do an incredible amount of work, not only in terms of inculcating sound moral principles, but by ministering to the sick and the homeless, and those stricken by disaster.

What is Revenue Canada's agenda? It is not to change the law; the law is still the same. It is to get at the tax abusers.

I hoped today to have provided you with some answers, or at least with a clearer insight. Unfortunately, clear answers will depend on where the facts point. The answers cannot always be categorical because the facts vary so much from one case to the other. Paying the charity for your travel costs and getting a tax receipt when you are out doing missionary work, is not the same as paying the charity for your travel costs for a European trip with a substantial amount of free time that essentially amounts to a vacation.

There is a dearth of regulation in Canada on this subject, but to the extent that abuse proliferates, we may eventually find ourselves in unfortunate circumstances similar to American charities, where - for instance - payments covering religious travel tours are tax-receiptable only if the tour includes for instance a reading list, attendance of a qualified instructor, a

maximum specified amount of free time per day and a minimum amount of hours of prayer, or work, or study - all of which the charity is required to fully account for.

We need clearer policy on gifting, that will foster genuine charitable activity without giving the Devil free rein. In this respect, I want to thank the Ontario Chapter of the Canadian Bar Association and the Evangelical Fellowship of Canada for having the foresight and the concern to try and address the policy problems constructively with Revenue Canada.

A number of us will be meeting in the near future to put a finer point on the policy as expressed in the Interpretation Bulletin, that addresses the needs for guidance expressed by religious charities.

In the meantime, and in closing, if you ever have any questions, you can call our 1-800-267-2384. You don't even have to identify yourself. Talk to us. If you want a written reply, if you think you are receiving contradictory advice or if you think the problem is too complicated to explain over the phone, write to us".

FOOTNOTES FOR "IS THE SKY REALLY FALLING?"

1. IT-110R3, "Gifts and Official Donation Receipts", modified June 20, 1997
2. The Overseers of the Poor and Chapelwarden of the Royal Precinct of the Savoy in the County of London v. The Art Union of London, 1896 A.C. 296.
3. Ibid., at p. 312.
4. Commissioner of Taxation of the Commonwealth v. McPhail, (1967-68) A.L.J.R. 346 at p. 347.

5. Leary v. Federal Commissioner of Taxation, (1980) 32 A.L.R. 221.
6. The Queen v. McBurney, 85 D.T.C. 5433, at p. 5436 (payments by the taxpayer to three religious schools attended by his children); Tite v. M.N.R., 86 D.T.C. 1788 (goods and services received in return); Campbell v. The Queen, 92 D.T.C. 1855 (payments to a Minister for teaching sessions); Dupriez v. The Queen, 1998 CanRepNat 997 (adoption services); see also The Queen v. Zandstra, 74 D.T.C. 6416 (payment of tuition fee at a Christian school claimed as a donation) Burns v. The Queen, 90 D.T.C. 6335 (payments to the Canadian Ski Association in recognition for coaching given to donor's daughter)
7. Wietse Posthumus, "Beware of Taxing Tactics by Corban and CCCC", in Christian Courier, November 13, 1998, pp. 12-13.
8. The Queen v. Friedberg, F.C.A. docket A-65-89, judgement dated December 5, 1991, page 3.
9. The Queen v. Zandstra, 74 D.T.C. 6416; The Queen v. McBurney, 85 D.T.C. 5433 at 5436.
10. "Tuition Fees and Charitable Donations Paid to Privately Supported Secular and Religious Schools", Information Circular 75-23 published September 29, 1975. See also Information Letter "Treatment of Tuition Fees as Charitable Donations Under Information Circular 75-23" sent to all newly-registered religious schools.
11. Ibid.
12. Note the difference in context between this, and the general rule regarding tax credits referred to in the Friedberg case, supra. See in particular Dutil v. The Queen, 95 D.T.C. 281.
13. Note that in the United States, a tax receipt for unreimbursed expenses is not allowed where a person other than the actual taxpayer performs the charitable service: Davis v. U.S., U.S.T.C. 88-2, 9594.
14. The Queen v. Friedberg, F.C.A. docket A-65-89, judgement dated December 5, 1991, page 3.
15. These suggested factors were gleaned from case law and various Revenue Canada files. I also relied on US Internal Revenue Service rulings. Factors such as these, especially when taken in combination, would logically bring Revenue Canada or a court to conclude that a payment was or was not a gift.
16. See Dupriez v. The Queen, 1998 CanRepNat 997.
17. Davis v. U.S., 88-2 U.S.T.C. 85,874 (funds sent by the taxpayers to their sons for personal expenses incurred while acting as missionaries for an organized church).
18. White v. U.S., 84-1 U.S.T.C. 83,234 (fee paid by the parents of a missionary to a travel agent, in accordance with church policy and whose primary purpose was to further the aims of the Church).

3. REVENUE CANADA'S REVERSAL ON GIFTING OF VACATION PROPERTY

BY TERRANCE S. CARTER

Charity & the Law Update, Volume 1, Number 1, dated September 1st, 1998 included a copy of an opinion that had been received from Revenue Canada explaining the circumstances under which charitable receipts could be issued for the fair market value of vacation property loaned to a charity, normally to be auctioned at a charity fundraising event. The full text of that article can be found at our web site www.charitylaw.ca.

That opinion, written by Carl Juneau, Assistant Director of the Charities Division, was a reasonable and fair interpretation of existing departmental policy at that time. The Rulings Directorate which is responsible for the policy, has recently

reversed its position, and is notifying taxpayers of the change in Bulletin ITTN-17. As a result, it would appear that no charitable receipts can be issued for the fair market value of the loan of property, including vacation property, to a charity. This change in position is apparently to be effective as of April 1999, and will mean that of vacation property offered for a charity auction is not a receiptable gift. As a result, charities should either not solicit a gift of vacation property from donors, or if they do, they should advise the donor in advance that no receipt can be issued by the charity for the value of the loan of the vacation property and that the donor should seek the advice of their professional advisors concerning the tax treatment of such gifts.

4. JULY 1st, 1999 PROCLAMATION DATE SET FOR NEW TRUSTEE ACT INVESTMENT POWERS IN ONTARIO

BY TERRANCE S. CARTER

Charity & the Law Update, Volume 1, Number 2, dated January 21st, 1999 included a summary of Bill 25 that amends the investment power provision of the Trustee Act in Ontario. Although the Act was given Royal Assent on November 30th, 1998, it was not to come into force until a date to be proclaimed. By an Order in Council published in the Ontario Gazette in April of 1999, the new investment powers under Bill 25 was proclaimed in force effective as of July 1st, 1999. For more information concerning the impact of Bill 25, reference should be made to the Charity

& the Law Update, Volume 1, Number 2 that can be found at our Web Site at www.charitylaw.ca

One of the more problematic aspects of Bill 25 is that it does not authorize trustees to delegate investment decision making, except in the limited situation involving mutual funds. Since most large charities rely upon investment dealers to not only advise on an appropriate investment policy, but also to make day to day decisions within the parameters of such investment policy, the omission by the Ontario government to deal with the matter of delegation, other than to allow investment in mutual funds, leaves

many charities in an uncertain position. For charities that, for practical reasons, delegate investment decision making to investment dealers, the more terms of reference and directions that can be built into an investment policy, the more that the board will be able to argue that their reliance upon investment dealers for day to day decision making in investments was done in accordance with the reasonable expectations of a "prudent investor" as opposed to being an unauthorized delegation of their investment decision making power.

However, it is not clear at what point the utilization of an investment dealer to make day to day investment decisions will constitute an unauthorized delegation of

investment power by the board of trustees or directors of a charity. As such, charities should either avoid delegating decision making on investment matters, or if they do, then they should work closely with their investment dealer and their legal counsel in developing an investment policy that will evidence due diligence in establishing and maintaining a reasonable and prudent investment portfolio. Until this matter is dealt with by the courts, the issue of delegation of investment decision making by boards of charities will remain an unsettled area and may leave some charities in a vulnerable position.

5. *Web Site Resource Materials*[/TOP](#)

Seminar materials, back issues of *Charity & the Law Update* and *Church & the Law Update*, as well as full texts of selected

articles and commentaries are available at our law firm web site at www.chaitylaw.ca

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