

CHURCH & THE LAW UPDATE

Terrance S. Carter, B.A., LL.B. - Editor

*Updating churches and religious charities on recent legal developments
and risk management considerations*

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EDITORS NOTE

Church & The Law Update is published without charge for distribution to churches, 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 *Church & 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. UPDATE FROM THE COURTS

A. WHEN IS A CHARITABLE TRUST NOT A CHARITABLE TRUST?

BY: TERRANCE S. CARTER, B.A., LL.B.

The recent decision of the Ontario Court of Justice involving the Christian Brothers of Ireland in Canada - (1998), 37 O.R. (3d) 367 - has raised uncertainties concerning whether or not a donor restricted charitable gift constitutes a charitable trust. The Court suggested that for a gift to constitute a charitable trust, the gift must meet the formal requirements of the three certainties of a trust, i.e., certainty of intention, certainty of subject matter, and certainty of objects. For example, the Court suggested that a building fund established to build a monastery might not constitute a charitable trust fund. If such funds are not a charitable trust, then the Board of the church or religious charity could exercise its discretion and apply the money to any of the charitable objects of the charity instead of to a specific project, such as a building fund, notwithstanding what the donors may have intended. The requirement for certainties in creating a special purpose trust fund could prove problematic for churches or religious charities if it results in an erosion of confidence with donors who are concerned that the gift intended for a specific project may be used by the charity for a different purpose.

Lawyers acting for donors will now need to ensure that their client's instructions result in the creation of a special purpose trust fund that binds the church or religious charity by ensuring that the three formalities of a trust are present when the gift is made, whether that be by will or otherwise.

The Christian Brothers decision is currently under appeal. A full commentary of the implications of the Christian Brothers decision with regard to charitable giving can be found in the article on "Donor Restricted Charitable Gifts - A Practical Overview" available from our firm for a nominal fee or from our Web site at www.charitylaw.ca.

B. WHEN CAN CHARITABLE ASSETS BE SEIZED?

BY: ADAM PARACHIN, B.A. (STUDENT OF LAW)

Another significant aspect of the Christian Brothers decision ostensibly flows from the fact that it constitutes a qualification to the long standing common law prohibition of the seizure of assets held in trust for charitable purposes. It has long been settled law that such assets are not subject to seizure. The Christian Brothers decision, however, allows such assets to be seized in certain circumstances, i.e., where there is a correlation between the damages suffered and the particular charitable trust in question.

In short, the Court in Christian Brothers held that the assets of a charity which are held in trust can be seized by tort creditors if the damages for which compensation is being sought arose in relation to the particular charitable trust in question.

As a result, churches and religious charities can no longer assume that charitable trust property is necessarily insulated from liability claims.

2. FEDERAL LEGAL UPDATE

A. REVENUE CANADA ISSUES DRAFT POLICY STATEMENTS ON FOREIGN ACTIVITIES AND POLITICAL ACTIVITIES

Revenue Canada has recently issued two draft policy statements, one entitled "Registered Charities: Operating Outside of Canada" and the other entitled "Registered Charities: Education, Advocacy and Political Activities". Both of these are available at the Charity Division Web site at www.rc.gc.ca. Submissions on these draft policy statements can be made until July 31, 1998 and August 31, 1998, respectively. More information concerning the implications of these policy statements will be contained in future issues of Church & the Law Update.

B. DIRECTED GIFTS AND BENEFITS TO DONORS

BY: TERRANCE S. CARTER, B.A., LL.B.

In June of 1997, Revenue Canada issued Interpretation Bulletin IT-110R3. Paragraph 15(f) of this Bulletin states Revenue Canada's position on the issuing of receipts for charitable gifts when the donor is either directly or indirectly receiving a benefit from the gift. The relevant wording from paragraph 15(f) is as follows:

"...[D]onations 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".

In a "Special Release" issued in April of 1998 by the Canadian Council of Christian Charities ("CCCC"), it was suggested that this paragraph, together with other recent positions taken by Revenue Canada, are indicative of a concerted effort to deny religious charities the ability to issue charitable receipts in many situations where they have traditionally been able to do so. According to the "Special Release", the cost to the religious community in Canada could amount to three billion dollars per year. It was recommended by the CCCC that aggressive action against Revenue Canada be taken, including establishing a two million dollar legal defence fund.

Revenue Canada has indicated a willingness to discuss both real and perceived concerns on this matter, as is evidenced by the following excerpt from a recently received letter written by Carl Juneau, Assistant Director of the Charities Division of Revenue Canada:

"...With regard to paragraph 15 (f) of Interpretation Bulletin IT-110R3, Revenue Canada has had to take a cautious approach in succinct public pronouncements about directed gifts. To say otherwise would have been to give free reign to those who would take tax receiving policy beyond its limits, and thereby encourage certain flow-through practices which are clearly outside the intent of the law. I will be the first to recognize that there are special cases where a gift for a named beneficiary can be deemed valid. However, these cases are an exception to the rule on tax receiving, and they will usually turn on the facts..."

It is expected that meetings will be held with Revenue Canada and various charitable organizations in the near future to clarify outstanding issues in a manner which should

avoid polarization or unnecessary legal action. Further information on these matters will be included in future issues of Church & the Law Update.

C. REVENUE CANADA'S POSITION ON USE OF VACATION PROPERTY

BY: TERRANCE S. CARTER, B.A., LL.B.

Many charities, including religious charities, receive gifts for the use of vacation property that is then offered for sale at charity auctions. Whether or not the gifting of the use of vacation property constitutes a gift of property for which a charitable receipt can be issued has been the subject matter of significant confusion in the charitable community. Recently, we had an opportunity to address this issue with Revenue Canada and received a succinct and reasonable response on a timely basis. Since the correspondence in this regard is relatively brief, both the letter to Revenue Canada as well as the response received from Carl Juneau are set out below.

As a result of Revenue Canada's position, a gift of the use of vacation property will generally be considered to be a gift of property for which a receipt can be issued, subject to the following condition: If the vacation property is regularly rented as a business, then the donor will need to include the usual retail value of the gift as income, although regular business expenses can be claimed during the same period of time.

1. Letter to Revenue Canada

"I am writing to follow-up with our discussions concerning whether or not a charitable receipt can be issued for the donation of va-

cation property that is subsequently sold at a charity auction.

The issue involves two scenarios. The first situation involves a donor who owns vacation property, whether it be in the form of ownership through a timeshare, condominium, fee simple, or leasehold interest, who offers to donate the use of the vacation property in question for a specified period of time to a charity, to be auctioned at a charity auction as a fundraiser. The other situation is identical to the first except that the donor regularly rents the vacation property in question to third parties as a rental business.

In the first scenario, i.e., vacation property that is not rented as a business, it is my understanding that the donation of the usage of vacation property would be considered to be either "a leasehold interest" or "personal-use property" under paragraph 3 of Interpretation Bulletin IT-297R2 and as such a receipt could be issued by the charity for the fair market of the usage of the vacation property, provided that the fair market value was determined and documented on an independent basis.

In relation to the second scenario, where the vacation property is regularly rented as a business, it is my understanding that the donation of the usage of such rental property would likely be considered to be inventory of a business in accordance with paragraph 3 of Interpretation Bulletin IT-297R2 that would allow the charity to issue a receipt for its fair market value..."

2. Response from Revenue Canada

I am replying to your letter concerning the donation to a charity auction of the use of vacation property.

At law, a gift is defined as a voluntary transfer of property where the donor receives no

benefit or valuable consideration in return. The transaction may not result directly or indirectly in a right, privilege, material benefit, or advantage to the donor or to a person designated by the donor. Any legal or moral obligation on the donor would cause the donation to lose its status as a gift.

It is a question of fact whether in a particular situation the donation of the use of vacation property would be a donation of services or a donation for a right to use property. A donation of services to a charity is not considered to be a gift for income tax purposes. However, there is nothing to prohibit a charity from paying for services and later accepting the return of all or a portion of the payment as a gift provided it is returned voluntarily. The donor must in such an arrangement, account for the taxable income that would be realized either as remuneration (in which case the charity would be obliged to issue a T-4 slip), or as business income. On the other hand, a right to use property for a period of time could be considered "property" within the definition of a gift.

In your letter, two scenarios are described. The first scenario involves an individual or a business who does not rent the vacation property as a business; however, in the second scenario, the vacation property is regularly rented as a business.

It is the opinion of the Charities Division that in the first scenario, the donation of the use of the vacation property would probably be considered the donation of a right to use property. Therefore, the donation would qualify as a gift, provided, of course, that the donor was under no obligation to donate the use of the property, and that no advantage was conferred upon the donor by reason of the donation.

Our position is based strictly on the information provided in your letter, and could

change subject to a material change in the circumstances. Additionally, I would advise you that our opinion is not binding on the Department. If needed, a binding ruling may be obtained from the Income Tax Rulings and Interpretations Directorate, located at 25 Nicholas Street, 15th Floor, Ottawa, Ontario, K1A 0L5, telephone (613) 957-8953.

If the donation of the use of the vacation property qualifies as a gift-in-kind, the charity may issue an official tax receipt for the fair market value of gift on the date it was received by the charity. You note in your letter that the fair market value of the use of the vacation property should be determined and documented on an independent basis. The Department concurs with this recommendation, both because the fair market value will be higher than the \$1000 guideline for independent appraisal, and also because determining the fair market value will likely be outside the expertise of the charity.

In the second scenario, you correctly note that the use of the vacation property, assuming it qualifies as a gift, would be a gift out of the inventory of a business. As with the first scenario, the charity receiving the gift may issue an official tax receipt, and the donor can claim a charitable tax deduction. However, the law requires businesses making gifts out of their inventory to include the usual retail value of the gifts in their income, while permitting them to deduct from income their associated business expenses. Thus, in the case at hand, a business could continue to deduct its business expenses for the property during the period its use has been donated to the charity.

I thank you for bringing this matter to us, and I trust that this information is helpful.

Signed Carl Juneau, Assistant Director of Charities Division, Revenue Canada

D. IMPORTANT CHANGES TO COPYRIGHT LAW IN CANADA FOR RELIGIOUS CHARITIES

BY: MERVYN WHITE, B.A., LL.B.

Bill C32, An Act to Amend the Copyright Act, was passed into law on April 25th, 1997. As a result, significant changes have occurred to copyright law in Canada. These changes should be understood by churches and religious charities and other users of copyrighted work if they are to avoid unnecessary litigation, as well as by authors and performers if they are to protect the copyright they own.

Copyright law can best be seen as a means of providing to those who create original works of authorship ("authors"), including literary, dramatic, musical, artistic, and certain other works, a limited means of controlling the dissemination of their works. With the changes it introduces to copyright law in Canada, Bill C32 is clearly designed to benefit authors. However, to accomplish this, users will be forced to pay more in royalties and administrative costs, and those who deal with work in which copyright subsists, including churches, will have to be more vigilant in enforcing copyright law and ensuring that infringement does not occur on their respective premises. All of these changes will amount to increased expenses in ensuring that infringement litigation is avoided.

Some of the changes which have been affected with the passing of Bill C32 include the following:

(i) Blank tape levies will be imposed on the sale of all blank audio tapes, in an effort to recoup some of the alleged losses suffered by music producers and publishers as a result of home publishing;

(ii) Copyright ownership has been increased to include a new group of owners, including Performances, Makers of Sound Recordings and Broadcasters. As a result, it will prove more difficult for users to ensure that all copyright owners have been contacted and the necessary authorizations to use works have been obtained when dealing with certain works. Administrative costs for the users will increase, as will the chance that a copyright owner has been overlooked, thereby inadvertently exposing users to a greater risk of being sued for copyright infringement;

(iii) Book distributors with exclusive distribution agreements for Canada have been given extensive powers to prevent the importation of copies created outside of Canada without their consent. The financial benefits of this to a distributor with an exclusive distribution right are momentous;

(iv) Increases in penalties for copyright infringement have been introduced, including a wide injunction allowing courts to impose broad restrictions on an infringing party, as well as statutory damages which will increase the monetary motivation for commencing litigation;

(v) Libraries and educational institutions will now have a series of specific exceptions to infringement actions available to them. But the trade-off for this may make any benefits gained seem more like a burnt offering. Libraries and other specific organizations which fit under the exceptions will be forced to play a far more interventionist role in the manner in which patrons use their material to ensure infringement does not occur. To the detriment of users, increased administrative costs should occur as a result of these changes.

The changes brought about by Bill C32 have increased the motivation for those who own copyright in works to enforce their rights.

The monetary incentive introduced with the changes to the penalties provisions and the entitlement of a number of new parties who now have an interest in works to bring an action for copyright infringement should lead to an increase in litigation. It should also lead to an increase in interested parties actively looking for royalties. It is recommended that those who use work in which copyright subsists be pro active in ensuring that they do not open themselves up to unnecessary and expensive litigation.

And it must be remembered that the exceptions available to ward off an allegation of copyright infringement are limited in number and scope. Do not simply assume that an exertion will apply. A review of the manner in which the work is being used with experienced legal counsel is advisable.

If a church or religious charity is fortunate enough to be the owner of copyright in a work, or have an interest in the copyright of a work, it should take sufficient steps to protect its interest, including registering its

copyright or copyrights, assignments or licenses and taking reasonable steps to enforce its interest against infringing parties. Failure to act may constitute a defense in litigation. Also, the increased monetary awards should act as clear financial incentive to take such pro active steps.

Employment situations, and, in particular, situations where parties are contracted to produce work in which copyright will exist, pose special challenges. Again, because of changes to penalty provisions, ensuring that infringement does not occur is of vital importance. Ensuring that full assignments of copyright interest and waivers of author's rights to control and ensure the integrity of the work are obtained has become of increased importance.

Finally, understand that the changes brought about by Bill C32 have made the exposure for infringement significant, while increasing the value of copyright ownership. Be pro-active. Guard existing copyrights, and guard against taking what belongs to others.

3. ONTARIO LEGAL UPDATE

A. TRUSTEE ACT AMENDMENTS TO INVESTMENT POWERS

- Bill 25 (formally Bill 122)

BY: TERRANCE S. CARTER, B.A., LL.B.

Proposed amendments to investment powers in The Trustee Act of Ontario were introduced in Bill 25, which received second reading in the Ontario Legislature on June 25, 1998. The proposed amendments to the Trustee Act would replace the detailed list of investments that a Trustee is authorized to

invest in with the general power to invest in any property that a prudent person would invest in, including mutual funds and common trust funds maintained by loan and trust corporations. The trustee will be required to exercise the care, skill, diligence and judgment that a prudent person would exercise in investing trust property.

These proposed amendments are identical to the ones which were contained in Bill 122, which Bill died when the Provincial Legislature prorogued in December of 1997.

The proposed trustee investment powers may have application to many charities that

are either incorporated in or operating in Ontario. Since there will be a mandatory list of investment criteria which must be complied with, the level of care the directors of charities will have to exhibit will be greatly increased. For a more detailed discussion of the practical implications of the amendments to the Trustee Act in Ontario proposed by Bill 25, a copy of an earlier article written by the author can be obtained for a nominal fee by contacting our office or from our Web site at www.charitylaw.ca.

B. SMALL BUSINESS AND CHARITIES PROTECTION ACT - BILL 16

BY: ADAM PARACHIN, B.A.

Bill 16, the Ontario Small Business and Charities Protection Act, received Royal Assent on June 11, 1998. It bodes significant tax implications for registered charities, including churches.

Among other things, Bill 16 amends the Municipal Act. Prior to Bill 16, section 442.1 of the Municipal Act gave municipalities the option of offering property tax rebates to registered charities. With the passage of Bill 16, it is now mandatory for single and upper-tier municipalities to provide such tax rebates to registered charities which occupy eligible properties, i.e., commercial and industrial properties as defined in the Bill.

Since registered charities need only "occupy" eligible properties to qualify for the rebate, it is not necessary that they actually own property in order to derive the tax benefits mandated by Bill 16.

As part of the phasing in of this scheme, Bill 16 gives municipalities the option - one available to them for the years 1998, 1999

and 2000 - of basing property taxes for registered charities on a frozen assessment value. If municipalities select this option, they will not be required to offer the tax rebate described above until the taxation year 2001. Even if this option is selected, however, registered charities will still benefit by having their property taxes in the years 1998, 1999 and 2000 reflect a depressed valuation of the property that they occupy.

C. NEW NOT-FOR-PROFIT INCORPORATOR'S HANDBOOK

The Public Guardian and Trustees office of Ontario has published a new Not-For-Profit Incorporator's Handbook which is available through the Ontario book store at 1-800-668-9938 or 416-326-5300. This publication is an essential tool for any charity operating in the Province of Ontario and contains substantial amendments from the previous edition of the handbook.

One problematic aspect of the new handbook is the requirement that applications for Supplementary Letters Patent will need to contain a provision that states that any assets held at the date of issue of the Supplementary Letters Patent or any assets received through wills or documents written before the date of the Supplementary Letters Patent will need to be dealt with in accordance with the prior objects of the charity. This will prove to be difficult for many charities and may very well result in directors of some charities being unnecessarily exposed to allegations of breach of trust if they do not carefully monitor the use of charitable funds or assets that were acquired prior to the date of the Supplementary Letters Patent or by means of a written document or will written before the said date.

4. GENERAL CHARITABLE LAW UPDATE

A. DONOR RESTRICTED CHARITABLE GIFTS - A PRACTICAL OVERVIEW

Many churches and religious charities are not aware of the legal obligations that are imposed upon them and their boards of directors as a result of the imposition of donor restrictions. The editor has recently prepared a paper entitled "Donor Restricted Charitable Gifts - A Practical Overview" for a recent continuing legal education seminar for the Canadian Bar Association of Ontario and the Canadian Association of Gift Planning on April 24, 1998.

A copy of the paper can be obtained by ordering the conference materials from the Canadian Bar Association of Ontario at 1-800-668-8900, by contacting our office to obtain a copy for a nominal charge or alternatively from our Web site at www.charitylaw.ca.

B. 1998 ANNUAL CHURCH AND THE LAW SEMINAR

The next annual Church and the Law Seminar is tentatively scheduled for February 3, 1999. It will be held in the Toronto area. More information concerning the Church & the Law Seminar will be available in future issues of Church & the Law Update.

C. WEB SITE RESOURCE MATERIALS

Back issues of Church & the Law Update, seminar materials and the full text of selected articles and commentaries are available at www.charitylaw.ca.

DISCLAIMER

This *Church & The Law Update* is a summary of current legal issues provided as an information service. It is current only as of the date of the article and does not reflect changes in the law that have occurred subsequent to that date. The article is distributed with the understanding that it does not constitute legal advice or establish the solicitor/client relationship by way of any information contained herein. The contents are intended for general information purposes only and under no circumstances can be relied upon for legal decision making. Readers are advised to consult with a qualified lawyer and obtain written opinion concerning the specifics of their particular situation.

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