

## **INQUIRIES STILL REQUIRED WHEN CHARITIES ISSUE DONATION RECEIPTS**

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### **A. INTRODUCTION**

New rules were proposed to be included in the *Income Tax Act* (Canada) (the “Act”) to permit a donor to receive a donation tax receipt even in situations where the donor or someone else received an advantage as a result of the gift. This is referred to as “split-receipting.” On July 18, 2005, the Department of Finance proposed a new obligation in this regard requiring charities to make “reasonable inquiries” of donors before issuing receipts over \$5,000 for gifts received after January 1, 2006. Although the Department indicated on November 22, 2005 that it is prepared to recommend to the Minister of Finance to withdraw this onerous proposed rule, charities are still required to exercise due diligence when issuing charitable donation receipts to ensure that the information on the receipts is accurate.

### **B. “REASONABLE INQUIRES” REQUIREMENT PROPOSED ON JULY 18, 2005**

Proposed changes permitting split-receipting were first introduced on December 20, 2002, which changes were further amended and new changes introduced on December 5, 2003 and February 27, 2004. These changes were consolidated and further amended in the legislative proposals released by the Department of Finance on July 18, 2005.<sup>1</sup> These changes generally apply to gifts made after December 20, 2002, with a few exceptions.

One of the most surprising new changes released on July 18, 2005 was the introduction of a new subsection 248(40) that would have imposed a heavy onus on charities to make inquiries of donors concerning gifts made on or after January 1, 2006. In particular, a charity issuing a donation tax receipt with a stated eligible amount in excess of \$5,000, whether gifts in kind or cash, would have been required to make a “reasonable inquiry” of the donor concerning the existence of any circumstances that would cause the eligible amount to be less than the fair market value of the property; for example, whether any advantage has been received by anyone, whether the donated property was acquired through a tax shelter, whether the donated property was acquired by the donor or any non arm’s length party within the last 3 years or 10 years and their cost of acquisition, and whether it would be reasonable to conclude that one of the main reasons for acquiring the property was to make a gift.

The charitable sector and its advisors were very concerned with the proposed statutory onus placed on charities when issuing receipts. It was not clear from the proposed changes what type of inquiry would be recognized to be “reasonable.” In response to a submission made by the Government Relations Committee of the Canadian Association of Gift Planners, Len Farber of the Department of Finance in a letter dated November 22, 2005 advised that the Department “recognize the difficulties that have been brought to light by this proposal” placing an administrative burden on charities. Mr. Farber indicated that the Department is “prepared to recommend to the Minister of Finance that proposed subsection 248(40) be withdrawn.”

### C. IMPLICATIONS OF THE REMOVAL OF THE REQUIREMENT TO MAKE “REASONABLE INQUIRES”

While the withdrawal of the proposed statutory onus on charities to make “reasonably inquiry” has been received as a relief to the charitable sector, charities will still have to exercise due diligence when issuing charitable donation receipts to ensure that the information on the receipts is accurate. In this regard, Mr. Farber stated in his letter that “charities will still be responsible to seek relevant information from donors where the need for such information is apparent to them in the particular circumstances.”

Although the proposed split-receipting rules have not been enacted, Canada Revenue Agency (“CRA”) released Technical News No. 26 on December 24, 2002 concerning proposed new rules for split-receipting which is premised on these proposed changes. The British Columbia Supreme Court in *Richert v. Stewards’ Charitable Foundation*<sup>2</sup> up-held compliance with Technical News No. 26, as required by CRA. In this regard, CRA’s *Registered Charities Newsletter* No. 17 specifically indicates that the proposed guideline in Technical News No. 26 “can be relied on now, despite the fact that the proposed legislation is not yet law.”

The level of inquiry to be made by charities to seek information will depend on the circumstances. It may be that the best approach to be taken by charities is to develop and implement a gift receipting policy conforming to the highest standard in the circumstances, such as a questionnaire for donors to complete and possibly requiring donors to provide sworn statements under certain circumstances. It is important for charities to advise donors that donation receipts will be issued in compliance with the requirement under the Act and that only the eligible amount of the gift, not the full value of the donation given, will be stated in the donation receipt for tax deduction purposes by the donors.

Charities will need to have a working knowledge of the proposed split-receipting and tax shelter rules in order that they may know when to “seek relevant information from donors where the need for such information is apparent to [the charities] in the particular circumstances” and what information to seek in this regard. Having such an understanding is not limited to accounting staff and senior management of charities, but also staff that may be in contact with potential donors, such as fundraising and gift planning staff, as well as staff involved in promotion and marketing, since they will be preparing publication and promotional materials for charities that may induce donations from donors.

Although the proposed subsection 248(40) will be drawn, the Department is silent on whether subsection 248(41) will be withdrawn as well. Subsection 248(41) was also proposed in July 2005, which provides that if a donor fails to provide relevant information to the charity relating to the existence of circumstances that would cause the eligible amount to be less than the fair market value of the property, the eligible amount of the gift would be deemed to be nil. Where a donor is not aware of the proposed changes and is not cooperative in providing information to the charity that exercises due diligence in making the inquiry, it is not clear whether the charity would have any liability vis-à-vis the donor. It would appear that at a minimum, a charity that believes that the split-receipting or tax shelter rules might apply should advise the donor of the possible consequence of not responding to the charity’s enquiries.

Charities are required to ensure that the eligible amount and the amount of the advantage shown on donation receipts issued by the charities are accurate. Otherwise, the charities may be subject to penalties under section 188.1 of the Act in respect of taxation years that begin after March 22, 2004. It is not clear whether the penalties and sanctions under subsections 188.1(7) and 188.1(8) for issuing receipts with incomplete or incorrect information or under subsection 188.1(9) and 188.2(1) for issuing receipts with false information would apply.<sup>3</sup> In addition to the possibility of imposing the said penalties, the Minister has the discretion to revoke the charitable registration of the charity.

When issuing split-receipts, it is important that the receipts contain the required information. In order to “make issuing receipts as simple as possible for charities and still meet the necessary requirements,” CRA provided sample official donation receipts attached to a letter released on October 3, 2005, concerning cash gifts and non-cash gifts, in situations involving an advantage having been received and not involving an advantage. The sample receipts are available on CRA’s website at:

<http://www.cra-arc.gc.ca/tax/charities/pubs/receipts-e.html>.

It is hoped that CRA will provide the charitable sector with administrative guidelines on the type of due diligence that would be required of charities when issuing split-receipts in this regard, such as what indicia that charities would need to be aware of in order to determine when to request information from donors, what type of information to request, how to document the requests made and information received from donors, and what steps to take when donors are not cooperative in providing information.

<sup>1</sup> The effects of these changes have been summarized in the following *Charity Law Bulletins*, all of which are available on our website at [www.charitylaw.ca](http://www.charitylaw.ca), and readers are encouraged to refer to them for more detail:

- December 2002 Amendments – See *Charity Law Bulletin* No. 21, “Commentary on Draft Technical Amendments to the *Income Tax Act* Released on December 20, 2002 that Affect Charities,” dated April 30, 2003.
- December 2003 Amendments – See *Charity Law Bulletin* No. 30, “Tax Shelter Donation Schemes,” dated December 16, 2003 and *Charity Law Bulletin* No. 38, “December 5, 2003 *Income Tax Act* Amendments Affecting Charities,” dated February 19, 2004.
- February 2004 Amendments – See *Charity Law Bulletin* No. 40, “February 27, 2004 Revised Draft Amendments to the *Income Tax Act* Affecting Charities,” dated March 29, 2004.
- July 2005 Amendments – See *Charity Law Bulletin* Nos. 76 and 77, “July 18, 2005 Draft Amendments to the *Income Tax Act* Affecting Charities: Part I – Definition of Gift & Split-Receipting and Part II – Other Changes,” dated September 8, 2005.

<sup>2</sup> [2005] B.C.C.J. No. 279. The appeal to the Court of Appeal on January 5, 2006 was dismissed.

<sup>3</sup> Under subsections 188.1(7) and 188.1(8), there would be a 5% penalty on the eligible amount stated on the receipt the first time a charity issues a receipt with incomplete or incorrect information and a 10% penalty on repeat infractions in five years. Under subsection 188.1(9), a 125% tax on the eligible amount stated on the receipt will be imposed, together with the suspension of tax-receipting privileges under subsection 188.1(1) if the total of all penalties under subsection 188.1(9) exceeds \$25,000 in a taxation year. Please refer to *Charity Law Bulletin* No. 82 “Changes to Sanctions, Penalties and Appeals Process for Charities,” dated January 11, 2006.