
BUDGET 2014: IMPACT ON CHARITIES

*By Karen Cooper, Theresa Man, Nancy Claridge, Sean Carter, Ryan Prendergast and Terrance Carter**

A. INTRODUCTION

Finance Minister Jim Flaherty introduced on February 11, 2014, the 2014 Federal Budget (“Budget 2014”).¹ While billed by some commentators as a “non event”, Budget 2014 included a number of surprises for the charitable and not-for-profit sector. Based upon statements made by the Minister of Finance in December 2013, there was an expectation by some that Budget 2014 might restrict the ability of charities to become involved in political activities, building upon the restrictions that had been introduced in the 2012 Federal Budget.² As a consequence, few federal budgets have been anticipated with more trepidation by the charitable sector. However, no such restrictions were included in Budget 2104, although it introduced an amendment to the *Income Tax Act* (“ITA”) that restricts the ability of charities and registered Canadian amateur athletic associations from accepting donations from a foreign state listed as a supporter of terrorism for purposes of the *State Immunity Act*, or from an agency of such a state.

On the flip side, there was little expectation that there would be any new tax incentives for charitable donations this year, but to the surprise of many Budget 2014 did contain a few welcome tax incentives, including encouraging Canadians to make additional donations of ecologically sensitive land by doubling the

* Karen J. Cooper, LL.B., LL.L., TEP, is a partner practicing charity and not-for-profit law. Theresa L.M. Man, B.Sc., M.Mus., LL.B., LL.M., is a partner practicing in the area of charity and not-for-profit law. Nancy E. Claridge, B.A., M.A., LL.B., is a partner practicing corporate/commercial and anti-terrorism law. Sean S. Carter, B.A., LL.B., is an associate practicing general and charity related litigation and anti-terrorism law. Ryan M. Prendergast, B.A., LL.B., is an associate practicing in the area of charity and not-for-profit law. Terrance S. Carter, B.A., LL.B., Trade-Mark Agent, is the managing partner of Carters, and counsel to Fasken Martineau DuMoulin LLP on charitable matters.

¹ The full text of the Budget 2014 document can be viewed at <http://www.budget.gc.ca>.

² See *Charity Law Bulletin No. 280* “Budget 2012: Including New Rules and Sanctions for Charities that Conduct Political Activities” at: <http://www.carters.ca/pub/bulletin/charity/2012/chylb280.htm>

5-year carry-forward period to ten years, as well as facilitating charitable giving by allowing increased flexibility to apply charitable donation credits against the income tax liabilities of the individual or the estate.

This *Charity Law Bulletin* provides a brief summary of these and some of the other more significant provisions from Budget 2014 that affect charities.

B. SUMMARY

1. Donations of Ecologically Sensitive Land

Currently, the *Income Tax Act* provides enhanced tax incentives (similar to those available in respect of publicly-traded securities), beyond those available in respect of ordinary charitable gifts, for gifts of full and partial interests in ecologically sensitive land made to eligible conservation charities, including land trusts, through the Ecological Gifts Program (EGP) administered by Environment Canada. However, the availability of the tax credit or deduction related to ecological gifts is currently limited to a 5 year carry-forward, which often results in some of the tax benefit arising from an ecological gift being unused. This is particularly the case for lands under significant development pressure (for example, coastal or waterfront properties, and lands in close proximity to growing urban areas) where land values have appreciated significantly. Such lands have often been held by the same owner for decades – frequently farmers or others on limited or fixed incomes – who do not have the income to offset the tax receipt over the 5 year period.³

Following a request by the Canadian Land Trust Alliance in its pre-budget submissions for 2012, the Notice of Ways and Means Motion filed in support of Budget 2014 proposes to amend subparagraph 110.1(1)(d)(iii) and paragraph (c) of the definition of “total ecological gifts” in subsection 118.1(1) to allow the charitable deduction or credit resulting from an ecological gift to be carried forward for ten (10) years, instead of the current five (5) years. This amendment will apply to donations made on or after February 11, 2014.

³ For a detailed discussion of Canadian and US tax incentives for conservation easement donations, including commentary on whether Canada’s EGP should adopt transferable credits, longer carry-forward periods, carry-backs, limited refundable tax credits, and intergenerational transfers of unused charitable credits see Ellen Zweibel & Karen Cooper, “Charitable Gifts of Conservation Easements: Lessons from the US Experience in Enhancing the Tax Incentive”, (2010) 58:1 Can Tax J 25.

2. Estate Donations

Another of the welcome proposed changes in Budget 2014 in order to provide tax incentives for charitable giving is to provide more flexibility to donations made by will for income tax purposes.

Currently under subsection 118.1(5) of the ITA, a gift made by an individual's will is deemed to have been made by the individual immediately *before* he/she died. Subsection 118.1(4) of the ITA provides that a gift made in the year of death is deemed to have been made in the year immediately prior to death to the extent that the tax credit for the gift has not been claimed in the year of death. This would allow the donation tax credit to be claimed in the individual's terminal tax return or in the year immediately prior to death. Similar provisions apply where an individual designates, under a Registered Retirement Savings Plan (RRSP), Registered Retirement Income Fund (RRIF), Tax-Free Savings Account (TFSA) or life insurance policy, a qualified donee as the recipient upon the individual's death of the proceeds of the plan or policy. On the other hand, tax credit for a gift made by the estate of a deceased person can only be claimed by the estate.

For deaths that occur on or after January 1, 2016, Budget 2014 proposes that donations made by will and designation donations will be deemed to have been made by the estate, at the time at which the property that is the subject of the donation is transferred to a qualified donee. As such, these donations will no longer be deemed to have been made by the testator immediately before death. To provide additional flexibility of the tax treatment of these gifts, the trustee of the estate will be able to allocate the donation made by will among any of the following: (a) the taxation year of the estate in which the donation is made; (b) an earlier taxation year of the estate; or (c) the last two taxation years of the deceased person.

A qualifying donation will be a donation effected by a transfer within the first 36 months after the individual's death of property to a qualified donee. In the case of a transfer from an RRSP, RRIF, TFSA or insurer, the existing rules for determining eligible property for designation donations will apply. In any other case, the donated property will be required to have been acquired by the estate on and as a consequence of the death (or to have been substituted for such property).

Subparagraphs 38(a.1)(ii) and (a.2)(ii) and 39(1)(a)(i.1) and section 118.1 of the ITA will be amended to effect these changes.

An estate will continue to be able to claim a donation tax credit in respect of other donations in the year in which the donation is made or in any of the five following years.

The current limits that apply in determining the total donations that are creditable in a year will continue to apply. In this regard, generally, the maximum amount of donations that may be claimed in a year is 75% of net income. Subsection 118.1(1) provides that the 75% limit does not apply in the year of the donor's death and the immediately preceding year. Therefore, donations made in the year of the donor's death and the immediately preceding year could be deducted up to 100% of the deceased's income in those years. However, a gift made by an estate may only be entitled to a charitable donation credit pursuant to subsection 118.1(3) up to 75% of the income of the estate.

Because of the additional tax benefits of gifts made by will that is currently available under subsection 118.1(5), determining whether a gift qualifies as a gift made by will has been a key consideration in estate planning in order to obtain the desired tax results. However, such a determination is a complex area because there is little case law dealing with what would constitute a gift made by will pursuant to subsection 118.1(5). The interpretation of this subsection has been, in the most part, in accordance with the positions taken by the CRA in its various interpretation bulletins, technical interpretations and rulings.

Since technical amendments to the ITA were not included in Budget 2014, it is not clear at this point whether the proposed changes mean that it will no longer be necessary to determine whether a gift is made by will. If such a determination is still necessary because the new benefits are only available to "gifts made by will", as opposed to gifts made by estates, it will become even more important for estate planners and solicitors to take care in structuring donations in wills to ensure desired tax result is achieved. It is hoped that the technical amendments to the ITA will provide clarity on this issue and hopefully provide a mechanism whereby it will no longer be necessary for estate planners and solicitors to navigate through the maze of the CRA in its various interpretation bulletins, technical interpretations and rulings in making such a determination.

3. Donations of Certified Cultural Property

A certified cultural property is a property of outstanding significance and national importance to Canada, for which a certificate has been issued by the Canadian Cultural Property Export Review Board. Like ecological gifts, the ITA provides favourable income tax treatment for the disposition of certified cultural property to institutions and public authorities designated by the Minister of Canadian Heritage. This favourable treatment includes a tax exemption for capital gains realized on the disposition of cultural properties to those designated institutions and, when disposition is by way of a gift to those institutions, the provision of a tax credit or a deduction to donors, up to 100% of their net income.

As part of the enactment of outstanding technical amendments to the ITA last summer, new subsection 248(35) of the ITA introduced a new deeming provision to require the fair market value of the property that is the subject of a gift, for purposes of determining the eligible amount of the gift under the new split-receipting rules, to be deemed to be the lesser of (i) the “fair market value of the property otherwise determined,” and (ii) the cost (or the adjusted cost base in the case of capital property) of the property to the donor immediately before the gift is made.⁴ Certain exceptions to this rule are listed in subsection 248(37) and currently includes in paragraph (c) gifts of cultural property. At the time of the initial introduction of these amendments, the exception for cultural property was included with other similar exceptions on the basis that the fair market value of the gift was independently determined and would, therefore, not be subject to a high degree of abuse.⁵

Continuing on the theme from last year’s Budget 2013 of taking proactive measures to curtail the use of tax shelters, Budget 2014 notes that donations of cultural property could be the target for abuse by tax shelters “because of the combination of its favourable tax treatment, inherent uncertainties in appraising the value of art and artefacts, and the exemption from the rule that deems the value of a gift to be no greater than its cost to the donor in certain circumstances.” As a result, the Notice of Ways and Means Motion filed in support of the Budget proposes to amend paragraph 248(37)(c) to limit the availability of the exception for gifts of cultural property to those gifts that have not been made as part

⁴ See “Federal Legislation Update” in *Charity Law Update* June, 2013 at: <http://www.carters.ca/pub/update/charity/13/jun13.pdf>.

⁵ See “Notice of Ways and Means Motion to Amend *Income Tax Act* Released” in *Charity Law Update* October, 2012 at: <http://www.carters.ca/pub/update/charity/12/oct12.pdf>.

of a gifting arrangement that is a tax shelter (as those terms are defined in the ITA). This provision will apply to donations made on or after February 11, 2014.

4. New De-Registration Power – State Support of Terrorism

It has been announced that section 149.1 of the ITA will be amended to enable the Minister of National Revenue to refuse to register a charity or revoke its registration if a charity or registered Canadian amateur athletic association (“RCAAA”) is determined to have accepted a “gift” from a “foreign state” listed in the *State Immunity Act*. At the present time only Syria and Iran are listed under the *State Immunity Act*, but this could change at any time with updated regulations and no legislative oversight.

The scope of the impact of these proposed amendments is potentially expanded by what would constitute a “foreign state,” which is governed by the *State Immunity Act*. The *State Immunity Act* provides an expansive definition of a foreign state, as it includes a sovereign or head of the state or any political subdivision (this could include presidents, state governors or provincial premiers); any government or subdivision of the foreign state, including any of its departments, and any “agency” of the foreign state (meaning any legal entity that is an “organ” of the foreign state but that is separate from the foreign state); and, lastly, any “political subdivision” (meaning a province, state or other like political subdivision of a foreign state that is a federal state). Even with only two states currently listed, one could imagine that there are still a significant number of ultimate entities from which charities need to avoid accepting gifts.

This proposed unilateral executive power to refuse registration or deregister that the Minister will have under Budget 2014 is without any specific review or appeal process, or access to the evidence relied on by the Minister. This new power would be in addition to the Minister’s similar deregistration power under the *Charities Registration (Security Information) Act*, a process by which a charity may be refused registration or have its registration revoked under the certificate process. This certificate process may be controversial (a similar process has been struck down by the Supreme Court in the immigration context), but still has a limited appeal and review process within it (for more information see www.antiterrorism.ca).

Budget 2014 also contemplates that CRA will “provide information about best practices” for exercising due diligence when “accepting gifts and for preventing terrorist abuse of the registration system for charities.” This should prove to be an important policy document to come considering the increasing due diligence burdens on registered charities and burgeoning executive powers of the Minister of National Revenue to block registration of charities and/or revoke existing charitable registration.

5. Consultation on Non-profit Organizations

Non-profit organizations (“NPOs”) are entities that are exempt from income tax but are not charities. NPOs are generally defined to be clubs, societies or associations that are organized and operated solely for social welfare, civic improvement, pleasure or any other purpose except to make a profit. NPOs include groups such as professional associations, recreational clubs, civic improvement organizations, cultural groups, housing corporations, advocacy groups and trade associations. Budget 2014 raises concerns that some organizations that claim NPO status earn profits that are essential to accomplish their non-profit purposes and, therefore, have additional funds to provide income to members or to create inappropriately large reserve funds. Additionally, there have been concerns that the limited reporting requirements for NPOs do not allow the Canada Revenue Agency or the public to properly assess the activities of NPOs. In Budget 2014, the government indicates its intention to review whether the tax exemption for NPOs is appropriately targeted and whether there are “sufficient transparency and accountability provisions in place.” This review will only be conducted on NPOs, not on registered charities or RCAAAs. In order to conduct the review, the government will be seeking comments on its soon to be released consultation paper and will consult with the appropriate stakeholders.

6. Reducing the Administrative Burden on Charities and other Investments in the Charitable Sector

a) Electronic Filing of Applications for Registered Charity Status and the Annual Charity Information Return

Budget 2014 proposed certain investments in order to “reduce the administrative burden on charities and measures to enhance public awareness of tax incentives for charitable giving.” In this regard, Budget 2014 proposed that funding be provided to CRA “enabling charities to apply for registration and file their annual information returns electronically.” These measures are estimated to cost \$23 million over five years.

Given the fact that a charity may lose its registered charity status if it fails to file the annual information return within 6 months of its year end, the ability to file electronically will more than likely be a welcome relief for the sector when the ability to do so becomes available. Many charities can become concerned when filing their annual return by mail or courier near the deadline. The ability to file electronically should alleviate this concern.

b) Amendments to the *Criminal Code* for Charitable Gaming

Although charitable gaming is generally within the jurisdiction of the provinces, since the regulation of gambling is a matter dealt with in the *Criminal Code*, charities are also restricted by federal law. In this regard, Budget 2014 recognized that restrictions within the *Criminal Code* on charitable gaming “forces charities to process and activate all sales manually, and then send customers their tickets by mail.” In response to input from large charities like the Heart and Stroke Foundation, Canadian Cancer Society and Sick Kids Hospital, Budget 2014 proposes to amend the *Criminal Code* so that charities may “use modern e-commerce methods for the purchasing, processing and issuing of lottery tickets and issuing of receipts to donors.” The Government of Canada will consult with the provinces and territories on the amendments to be made to the *Criminal Code*. The ability for charities to use modern technology to conduct charitable gaming activities will be a great reduction in the administrative burdens faced by charities that do such activities.

c) Social Finance Initiatives

Budget 2014 announced that the government will “continue to work with leaders in the not-for-profit and private sectors to explore the potential for social finance initiatives.” In doing so, Budget 2014 acknowledged that governments are “not always best placed to solve the most pressing or persistent social and economic problems,” which although a cathartic statement to many in the sector, it is still a welcome admission, particularly when contained in a federal budget.

Although Budget 2014 did not include an announcement of any specific proposals concerning social finance, it did indicate that a new Ministerial Advisory Council on Social Innovation had been formed in December 2013 made up of experts and practitioners in the fields of social

finance and social enterprise to advise the government on possible areas of social finance initiatives and whether there might be barriers to their success. This consultation is similar to ones that have happened and are planned at the provincial level. Hopefully, the federal government will coordinate efforts with their provincial and territorial counterparts on this important area of innovation.

d) Grants and other Initiatives in Arts, Culture and Sports

Budget 2014 also announced investments to be made in arts, culture and sport. These include funding of:

- \$25 million for the Canada Council for the Arts;
- \$30.1 million for the Canada Cultural Investment Fund;
- \$30 million for the Canada Cultural Spaces Fund;
- \$18 million for the Canada Arts Presentation Fund; and
- \$1.8 million for the Fathers of Confederation Buildings Trust.

As well, Budget 2014 includes ongoing funding of \$9 million per year to the Canada Book Fund and \$8.8 Million per year to the Canada Music Fund. Funding for the Virtual Museum of Canada will also be raised from the existing \$2 million per year to \$6.2 million, with an additional grant of \$1.2 million for the Online Works of Reference project of the museum, which will be transferred to the Canadian Museum of History.

To coincide with the current Olympics and in anticipation of the 2015 Pan American Games and Parapan American Games in Toronto, the government also announced grants to Sport Support Canada for a total of \$23 million dollars. As well, Budget 2014 proposed to amend the current rules for amateur athlete trusts “to allow income contributed to an amateur athlete trust to qualify as earned income for the purposes of determining an athlete’s annual RRSP contribution limit. This will provide a particular benefit to amateur athletes who are members of an RCAA and can establish an amateur athlete trust. Given that the measure will apply to contributions made after 2013 and the current Olympics, the proposal appears well timed.

C. CONCLUSION

For a budget that few anticipated would contain substantive changes other than a general threat of harsher provisions in order to stop charities becoming involved in terrorist financing, Budget 2014 contains a surprising amount of substance for consideration. Although the proposed initiatives contained in Budget 2014 include more detail than what the Notice of Ways and Means Motion does, the initiatives that were included provide much upon which the sector may reflect. In particular, Budget 2014 signals that the federal budget in 2015 may contain a significant revision of the section 149(1)(l) of the ITA concerning non-profit organizations, and as such it will be important that such organisations carefully follow this development over the next year.