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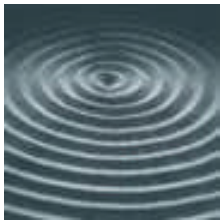

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Draft technical bill makes several changes regarding charities

Robert B. Hayhoe

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WILLS, ESTATES, CHARITIES & TRUSTS

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By Robert B. Hayhoe

On Dec. 20, 2002, the federal Department of Finance issued draft technical legislation to amend the *Income Tax Act* (ITA). Included in the legislation was a number of changes relevant to charities.

Avoiding private foundation status

Prior to the technical legislation's introduction, the ITA contained an anomaly in the definitions of both "charitable organization" and "public foundation" in subsection 149.1(1). A large gift to a charitable organization or public foundation could cause the recipient to become a private foundation if the gift caused the recipient to have received more than 50 per cent of its capital from one person or non-arm's length group of persons.

As indicated in previous comfort letters, Finance recognized that this was not an appropriate result. As a result, the technical legislation amends (effective 1999) the definitions of public foundation and charitable organization to replace the 50-per-cent-of-capital-contributed test with two new tests.

The first requires that at least 50 per cent of the directors or trustees deal at arms length with any donor or group of donors who have contributed more than 50 per cent of the recipient's capital.

The second requires that the recipient charity not be controlled by any donor or group of donors who have contributed more than 50 per cent of the recipient's capital.

Foundations making foreign grants after disbursement quota

Prior to Dec. 20, 2002, the ITA was quite clear that a registered charity that was a private or public foundation could make charitable grants to entities that were not qualified donees, provided that the foundation met its disbursement quota by making grants to qualified donees. Some foundations used this right to allow them to make grants to foreign charities.

The Canada Customs and Revenue Agency (CCRA) challenged such grants, despite the lack of any real legal basis for its position. A few years ago, the Wolfe & Millie Goodman Foundation reacted to the CCRA's position by seeking guidance from the Ontario courts. The CCRA responded to the litigation by admitting privately that its position was wrong, but promised to seek an amendment to the ITA.

The technical legislation amends subsections 149.1(2), 149.1(3) and 149.1(4), which provide grounds for revocation of registration to provide that a registered charity which makes a gift other than in the course of its own charitable activities or to a qualified donee may have its registration revoked by the CCRA. Thus, foundations may no longer make charitable grants to organizations that are not qualified donees

Robert B. Hayhoe

Finance on split receipting

Tax recognition for contributions to registered charities is only available if the contribution constitutes a "gift". While the ITA does not define the term, the common law usually defines "gift" as a voluntary transfer of property made without consideration.

Most court decisions that have applied this definition have concluded that if there is anything of value transferred to the intended donor, the entire transaction ceases to be a gift. On the other hand, the *Civil Code of Quebec* clearly permits a transfer of property to be split between a gift element and a sale element. Since tax law follows the general law, the tax treatment of some charitable contributions was different in Quebec from that in the rest of Canada.

In order to remove this difference between the tax law of gift in Quebec and the rest of Canada, subsections 110.1(1) and 118.1(1) of the ITA are amended in the technical legislation to provide that a receipt may be issued for the "eligible amount" of a gift.

Eligible amount is defined in new subsection 248(30) as the difference between the fair market value of the property transferred to a charity and the "advantage" which accrues to the donor by virtue of the gift. Advantage is defined by new subsection 248(31) as, in essence, the benefit to the donor which accrues or is received because of the gift.

Pursuant to new subsection 248(32), provided that the advantage is less than 80 per cent of the total fair market value of the property transferred, a gift is presumed. If the advantage exceeds 80 per cent, the donor will have to show donative intent. The Finance technical notes accompanying the draft legislation also confirm that Income Tax Regulation 3501 is to be amended to require the recording of the eligible amount and the advantage on official donation receipts. While the technical notes suggest that the change to donation receipt requirements would take effect December 20 when the substantive changes take effect, the CCRA confirms privately that (as an interim measure, at least) registered charities may continue to issue receipts in the past form for gifts which do not involve an advantage.

CCRA on split receipting

There will be a large number of interpretive issues flowing from the above legislative

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Transfer of mortgaged property can now be a gift

TAX CHANGES

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changes on donations with an advantage (also known as "split receipting").

On Dec. 24, 2002, the CCRA issued Technical News No. 26 (*http://www.ccra-adrc.gc.ca/tax/technical/incometax/itnews3-e.html*) which contains a draft policy setting out the CCRA's views on when split receipting is appropriate. The document is a good start on covering off some of the issues arising from common split-receipting situations like fund-raising events and dinners, charity auctions and lotteries, shows, and golf tournaments.

The new policy also withdraws (effective Dec. 21, 2002) Interpretation Bulletin IT-111R2 dealing with annuities purchased from charitable organizations.

Charities that are authorized to issue annuities should be advised to consider the effect that this change will have on their annuity programs.

Finally, the CCRA now accepts that the transfer of mortgaged property to a charity can be a gift. The eligible amount of the gift is typically the value of the property less the fair market value (not necessarily the principal amount) of the mortgage.

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