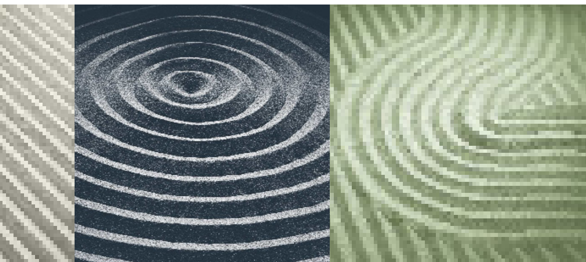

MILLER THOMSON LLP

Barristers & Solicitors, Patent & Trade-Mark Agents

CHARITIES & NOT-FOR-PROFIT NEWSLETTER

March 2004

The Charities and Not-for-Profit Newsletter is published periodically by Miller Thomson LLP's Charities & Not-for-Profit Group as a service to our clients and the broader voluntary sector. We encourage you to forward the e-mail delivering this newsletter to anyone (internal or external to your organization) who might be interested. Complimentary e-mail subscriptions are available by contacting charitieseditor@ millerthomson.ca.

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MILLER THOMSON VANCOUVER SEMINAR

Miller Thomson's Charities and Not-for-Profit Practice will be presenting a seminar in Vancouver on the morning of May 19. Arthur Drache, C.M., Q.C., the leading charity tax lawyer in Canada and a new addition to Miller Thomson, will be among the presenters. Watch for details and an invitation in the April issue of this Newsletter.

TAX COURT REJECTS RETAIL VALUE FOR CHARITABLE DONATION OF ART*

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In February, Associate Chief Justice Bowman of the Tax Court of Canada issued his decision in *Klotz v. The Queen*, in which he rejected retail value as the appropriate fair market value in the context of an art donation program.

In 1999, Mr. Klotz was a very successful derivatives trader. Like many other successful professionals, he was approached by his financial advisor with a charitable donation program proposal (this one called Art for Education) to purchase works of art (in this case fine art prints) at wholesale (in this case about $300 per print) from a promoter (here Curated Prints Ltd.) with an associated retail valuation report opining that each print was worth $1,000. The promoter would then arrange for him to donate the art to a qualified donee (here Florida State University) which would issue him an official donation receipt for $1,000 per print. He could then claim a charitable donation tax credit worth approximately $450 per print in tax savings. Mr. Klotz bought 250 prints for just over $75,000, then donated them at a claimed value of just over $250,000.

The Canada Customs and Revenue Agency assessed Mr. Klotz on the basis that the prints given had a value of $300 each, the amount paid by Mr. Klotz. The Crown also took the position that the prints were not personal use property. This was relevant because gains on personal use property worth less than $1,000 are not taxable, while gains on other capital property are taxable. The Court rejected the Crown's argument on personal use property, finding that one way an individual can "use" property is to give it away (the Crown had argued that because the prints had never been hung on the wall by Mr. Klotz, there had not been personal *use*.)

However, the Court accepted the Crown's valuation approach. Mr. Klotz had relied upon a valuation prepared by the promoter. This valuation was prepared on the basis that the best comparable market prices were retail prices in New York City galleries and dealer catalogue prices for similar prints by the same or similar artists.

The Court began its analysis of valuation by outlining in some detail the factual background of the purchase of the print by the promoter's representative (all purchased for less than $50 each and some purchased for as little as $5). The Court then pointed out various flaws in the appraisal (including the curious observation that virtually all of the donated prints were valued at $1,000 despite being different works by a number of different artists). However, Justice Bowman's more fundamental objection was that the New York retail print market was, quite simply, the wrong comparable market.

The Court's approach was to look for the best evidence of what a lot of 250 prints would sell for - the Court found that Mr. Klotz's purchase price of $300 each was the best evidence (although Justice Bowman mooted that the promoter's purchase price of $50 per print was also arguable). Justice Beaubier of the Tax Court (in *Malette v. The Queen*) and Justice Mogan of the Tax Court (in *Pustina, Whent and Zelinski v. The Queen* - upheld by the Federal Court of Appeal) had previously rejected the application of any form of bulk discount in valuing donations of art. Justice Bowman distinguished these decisions by characterizing his approach as a bulk valuation rather than a bulk discount.

The Court accepted the Crown's approach that the market for art for donations was so large that it formed its own distinct market for valuation purposes. This tax shelter market is a bulk market and bulk pricing should be applied. This valuation theory was based upon a series of US Tax Court cases which had come to a similar conclusion in examining similar programs which had been promoted to US donors. While the Court acknowledged the existence of a specific US tax regulation requiring that donation valuation be on the basis of the market in which the item is "most commonly sold to the public," Justice Bowman placed little importance on this distinction.

It is perhaps also arguable that the *Income Tax Act* charitable donation provisions specifically contemplate separating bulk gifts into their constituent parts - an approach that may not be consistent with a bulk valuation. At the relevant time, the definition of "total charitable gifts" in subsection 118.1(1) referred to "the *total* of all amount *each* of which is the fair market value of a gift" (emphasis added).

It will be interesting to see how the *Klotz* decision is applied as the Crown and the Tax Court work through the appeals arising from the thousands of assessments in which the Canada Revenue Agency has reassessed donations of art and other similar objects. At one level, the *Klotz* decision could be read as a decision based on the facts of the case that the particular appraisal was not defensible. On the other hand, it could also be read for the proposition that mass market charitable donation programs must be, by definition, valued at the purchase price of the donated goods. In any event, we have not heard the last on art donation valuation. This decision will almost certainly be appealed to the Federal Court of Appeal by Mr. Klotz (and the other Art for Education donors).

*Based on an article published in *Lawyers Weekly*

SENATE COMMITTEE STUDIES GIFTING POLICIES*

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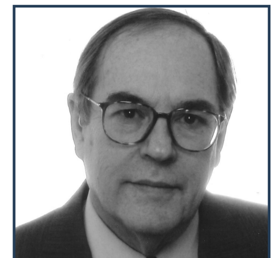

On February 26, Senator Richard Kroft, Chair, and Senator David Tkachuk, Deputy Chair of the Standing Senate Committee on Banking Trade and Commerce, announced a new study into charitable giving in Canada by the Committee. This initiative can only be welcomed by the sector. While there had been rumours that this Senate Committee, then under the Chairmanship of Leo Kolber, would take a look at issues of charitable giving, Senator Kolber resigned towards the end of 2003 and nobody knew whether his idea would be pursued.

"The Committee has taken an interest in the issue of charitable giving," said Senator Kroft. "Our study will try to determine whether new or enhanced policy measures might be taken to stimulate increased charitable giving and bring about more and better programs, institutions and services for the benefit of Canadians everywhere."

"Our principal target will be tax policy," stated Senator Tkachuk. "We want to determine what can be done to enhance the opportunities for affordable giving by Canadians at all income levels, where the potential for such giving exists."

The Committee planned to commence hearings in Ottawa the week of March 8, and expected to hear from a wide range of witnesses including those from the health care, education, social services, scientific, cultural, heritage preservation and other sectors. The Committee will also hear from professional and volunteer fundraisers as well as tax and other experts, academics and other interested parties.
The formal terms of reference reads as follows:

> That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report on issues dealing with charitable giving in Canada. In particular, the Committee shall be authorized to examine:
>
> - the needs and opportunities of Canadians in relation to various aspects of Canadian life (such as health care, education, social and cultural programs and institutions, senior care, heritage preservation, scientific research and more) and the ability of Canadians to assist in these areas through charitable giving;
> - current federal policy measures on charitable giving;
> - new or enhanced federal policy measures, with an emphasis on tax policy, which may make charitable giving more affordable for Canadians at all income levels;
> - the impact of current and proposed federal policy measures on charitable giving at the local, regional and national levels and across charities;
> - the impact of current and proposed federal policy measures on the federal treasuries;
> - any other related issues; and
> - that the Committee submit its final report no later than December 31, 2004.

Timing of the Committee's activities and any resulting report will depend to a great extent on when an election is called and the result of that vote.

The Committee's membership also includes Senators David W. Angus, Michel Biron, D. Ross Fitzpatrick, Mac Harb, Céline Hervieux-Payette, James F. Kelleher, Paul J. Massicotte, Michael A. Meighen, Wilfred P. Moore and Marcel Prud'homme.

The process appears to be fairly lengthy, probably six to eight months, depending upon when the federal election is called. The problem is that once Parliament is prorogued, the Committee ceases to exist until the recall. Thus, it is easy to contemplate that there might by a hiatus of three or four months.

In the first instance, we expect that the Committee will be looking for evidence to create a policy framework. Rather than jump into questions of where this or that particular tax rule should be changed, the Committee will want to set some policy goals and only thereafter, look at specifics within those policy objectives. For example, it might consider the role of private foundations within Canadian society. Only after determining what such foundations currently do, can do or should do, can the Committee make a determination as to whether the various impediments put in the way of funding private foundations are reasonable.

For further information, to appear as a witness or to provide a written submission, contact the Committee's Clerk at the address below.

> The Standing Senate Committee on Banking, Trade and Commerce
> The Senate
> Ottawa, Ontario K1A 0A4

Realistically, those in the sector have to understand that even a sympathetic report by the Committee will have no direct legal impact on the issues in question. The Finance Minister will make decisions and the Senate cannot initiate tax legislation. That having been said, the Senate offers a great forum for the expression of views and there is no doubt that the ideas which are presented to Senator Kroft's Committee will get an airing, and that recommendations may well have a persuasive effect.

We would guess that major themes will be the bias against private foundations inherent in the *Income Tax Act*, concerns about smaller organizations and ways in which they may benefit from tax incentives as well as the notion that there should be no capital gains taxation at all on gifts of appreciated property.

*Based on a similar *Canadian Not-for-Profit News* article by the author.

BILL C-45: CRIMINAL LIABILITY AND WORKPLACE SAFETY*

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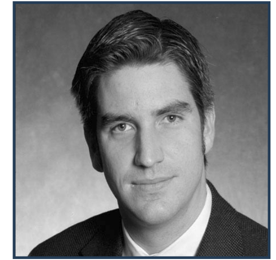

In 1992, 26 miners perished in an underground explosion at the Westray Mine in Nova Scotia. It was widely felt that the explosion could have been avoided had the mine's owners and managers paid heed to repeated safety warnings. In response, the Federal government introduced amendments to the *Criminal Code* (the "Code") designed to increase corporate responsibility for workplace safety. The amendments are contained in Bill C-45 which received Royal Assent on November 7, 2003 and will be proclaimed in force on March 31, 2004.

The Bill increases corporate accountability by amending the definition of "everyone" and "person" in s. 2 of the Code to include "an organization". The amendment expands the applicability of the Code to include firms, partnerships and trade unions in addition to public bodies, societies, companies and municipalities. The second part of the definition is expanded further to include "any association of persons". The effect of the changes is to include associations that would have previously been excluded because they lacked a "legal personality", such as unincorporated charities and non-profit associations.

It is significant for charities and non-profit organizations that the Bill also amends Part I of the Code by adding new provisions setting out the rules for attributing criminal liability to organizations for the acts or omissions of their representatives. Not only do the new attribution rules codify existing common law, they also expand the range of individuals whose actions and intentions will attract criminal liability for the organizations they represent. The Code now applies to "representatives", which essentially includes every volunteer, employee, agent or affiliate of an organization and "senior officers". A senior officer is anyone involved in policy-making or management and includes directors, chief executive and financial officers. Gone are the days where only the "directing mind" could attract criminal liability for an organization.

The amendments require organizations to be proactive in their approach to workplace safety. The Bill criminalizes an act or omission of an organization that demonstrates a reckless disregard for the lives or safety of others. For instance, a manager who ignores a volunteer's failure to abide by safety precautions may be held liable for failing to enforce safety policies. Further, the Code now imposes a legal duty on those who direct the work of others to take reasonable steps to prevent employment related injuries. Previously, corporations could be convicted of criminal negligence; the codification of this legal duty will make it easier to obtain convictions for the workplace safety violations, or omissions, of individual "representatives" or "senior officers".

Another significant change is that liability can now be attributed to an organization in one of two ways. The first is on the basis that one or more "senior officers" actually participated in the offence. The second is based on the actions of one or more "representatives" combined with the intent and negligence of one or more "senior officers".

What Can Organizations Do?

The first step is to develop a clear set of policies and procedures. Management should outline the requirements and expectations of employees and volunteers. This starts with the development of a general code of conduct and continues with the dissemination of specific safety policies tailored to the activities of the organization. This enables management to set behavioral benchmarks while communicating potential

risks. Once the risks are identified, management can then address what the organization has done to mitigate those risks and develop guidelines for employees, or volunteers, to follow in order to avoid or reduce the severity of the risk.

Another strategy for employers, if a particular job carries a heightened level of risk, is to include a list of the job's associated risks in the employment contract. In this way, potential risks and the employer's desire to mitigate those risks is clear. Many employers send new employees on training courses to learn new skills prior to commencing work. It is equally important for employers to send new employees on safety training for jobs that present a safety risk, prior to their first day of work. This strategy is equally applicable to volunteers.

It is imperative that management listen to the comments and reports issued by health and safety committees. To be effective, these committees should conduct regular safety assessments in the workplace. If a safety hazard is identified, it should be reported and remedial action should be taken immediately to eliminate or reduce the hazard. Wanton disregard for these reports could result in a criminal conviction, if the hazard causes serious injury or death.

Prior to Bill C-45, liability would only have resulted if it could be proven that a "controlling mind" was aware of and ignored a safety risk. Now, for instance, if the health and safety committee identifies a safety hazard during a committee meeting at which a "senior officer" is present, management is required to address the risk or be found liable for their inactivity if an accident subsequently occurs.

The expectation is that organizations will become proactive instead of reactive. The broad application of the Bill C-45 amendments should not be under estimated. If an organization hires a short term employee or accepts a volunteer, it will be held responsible for the safety of that individual. The Bill increases accountability for all organizations and in so doing will hopefully make everyone more conscientious of the need to address safety concerns as they arise.

Miller Thomson lawyers are experienced at reviewing and drafting health and safety policies. We also have extensive experience defending occupational health and safety prosecutions. Given the potentially dire consequences for an organization and its management which can result from criminal and other occupational health and safety prosecutions, it is important that legal counsel be contacted when serious workplace injuries occur.

* This article is based in part upon an earlier article by David Whitten and Kelly Townsend (Grant Thornton LLP) with the same title which first appeared in the February 24, 2004 issue of the *Law Times*.

INTERPROVINCIAL ALLOCATION OF PROBATE FEES

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Charities which receive bequests should be aware of the case of *Re: The Estate of Bessie Bloom, Deceased*, a January 2004 decision of the Supreme Court of British Columbia. The issue in the case was the test to be applied in determining the location or *situs* of shares, bonds and debentures for the purpose of assessing probate fees under the *Probate Fee Act* of British Columbia. Subsection 2(1) of that Act provides that a fee must be paid to the British Columbia government before a grant of Probate or administration will issue. The fee is calculated on the value of the property of the deceased "situated in British Columbia" that passes to the personal representative at the date of death. Similar rules apply in various other provinces.

The applicant for the grant of administration in the *Bloom* case sought to avoid paying probate fees on the shares, bonds, and debentures held by the estate (the "Securities") on the basis that the Securities were not "situated in British Columbia". The Probate Registry of the British Columbia Supreme Court took the position that the Securities were situated in British Columbia. The applicant accordingly sought a declaration from the Court.

Bessie Bloom had lived in British Columbia. She had not purchased the Securities personally. They had been purchased by her Committee, at that time the Bank of Nova Scotia Trust Company (the "Trust Company") for her committeeship account by the Securities Department of the Trust Company in Toronto, Ontario. The purchase was effected through the book entry system maintained by the Canadian Depository for Securities Limited ("CDS") located in Toronto.

The facts, as determined by the Judge in the case, were as follows. No certificates were issued for the securities. Ownership was evidenced by electronic entries in the books of the Securities Department of the Trust Company and CDS. Transfer of the Securities could only be effected on the books of the Trust Company and CDS in Toronto. The transfer agents for all the Securities were also located outside British Columbia. If physical certificates had been issued for the Securities, they would have been obtained from the transfer agents and kept in safekeeping by the Trust Company in Toronto.

The Judge considered the electronic transfer of securities and tried to reconcile electronic transfer with the *situs* rules of the common law. He found that the common law *situs* of corporate shares is the place where they can be effectively dealt with between the purchaser and the company. However, the manner in which securities are held today has changed substantially from how they were held when the common law *situs* rules were determined. The common law rules are based on old case law. Today, it is common to use an indirect multi-tiered holding system where the securities are held through an intermediary such as a broker, bank or trust company, which in turn is a member of an upper tier intermediary such as CDS. CDS (incorporated in 1970) is owned by major banks, members of the TSE and members of the Investment Dealers Association. Its participants include banks, trust companies, investment dealers and life insurance companies.

Participants deposit their existing securities with CDS, which then holds the registered title to the securities in "fungible bulk". CDS keeps a record of each participant's entitlements. Each participant keeps a record of their respective client's beneficial holdings. This is called an "indirect holding system".

The British Columbia government argued that in such a system, *situs* of securities should be "where the deceased most likely would have gone to conduct a securities transaction" and since Bessie Bloom lived in British Columbia and conducted her banking and investment transactions with a Vancouver branch, the Securities were sited in British Columbia and therefore subject to British Columbia probate fees. The applicant argued that since the transfer of the Securities could only be effected by entries on the books of the Securities Department of the Trust Company and CDS, both of which were in Toronto, Toronto was the *situs*.

After reviewing the legislative history of the *Probate Fee Act* and the common law principles for determining *situs*, the Court found that in a multi-tiered holding system, securities would be situated at the financial investment intermediary on whose books the interest of the deceased is recorded and where the personal representative would go to effect the transmission. In Bessie Bloom's case, it was the Securities Department of the Trust Company in Toronto, and accordingly, probate fees in British Columbia should not be paid.

Given that many of the major banks, trust companies, brokers and custodians for money managers maintain centralized record keeping functions for securities in Toronto and participate in CDS, it is arguable that all such securities are sited in Toronto and not subject to probate fees in any other province. Whether grants of probate or administration in Ontario will now be required by institutions holding such securities before it will transmit them may be a concern. This would expose the clients of such institutions to the probate fees of Ontario, the highest in the country.

This case will be of interest to those who work in the estate and bequest administration departments of charities. If there are securities in an estate where the charity has a residuary bequest, proper payment of probate fees is an accounting issue.

The *Bloom* decision has been appealed by the British Columbia government.

NO RELIEF FROM TAX WITHHOLDINGS ON COMPASSIONATE GROUNDS FOR NON-PROFIT CORPORATION

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All employers, including non-profit corporations, have an obligation to remit employee source deductions to Canada Revenue Agency within a prescribed period of time. Failure to remit within the prescribed time will attract interest and penalties under the *Income Tax Act*. The recent Tax Court of Canada decision in *Portland Hotel Society v. the Queen* highlights the obligations of non-profit corporations to comply with the *Income Tax Act* and the willingness of the Court to enforce the penalty provisions under the *Income Tax Act* against non-profit corporations.

The Portland Hotel Society (the "Society") is a non-profit corporation which provides social housing in the City of Vancouver. The Society purchased two buildings which were to be renovated and occupied for social housing. Prior to the renovations, the Society was caught in a financial squeeze. The Society incurred significant costs in maintaining the buildings and as a result, was late in remitting the source deductions which had been taken on the payroll of its employees. Canada Customs and Revenue Agency (now Canada Revenue Agency) assessed late penalties on the late remittances. The Society objected to the penalties and applied to the Court for relief on compassionate grounds. The Tax Court of Canada held that the Court does not have the authority to reduce the penalty or cancel it on compassionate grounds.

This case is a good reminder that charities and non-profit corporations are equally as liable as any other organization for penalties under the *Income Tax Act*. Directors of non-profit corporations also need to understand that they may have personal liability for the corporation's failure to make required tax withholdings.

WHAT'S HAPPENING AROUND MILLER THOMSON LLP

In January, **Arthur Drache** spoke to the Ottawa Estate Planning Council on "Life Insurance and Charitable Giving: Doing Well by Doing Good".

Susan Manwaring of our Toronto office has been appointed to the Uniform Law Commission of Canada's Working Group on Charitable Fundraising. The Working Group will be considering the advisability of uniform fundraising regulation for Canada.

Arthur Drache continues as editor of Carswell's monthly *Canadian Not-for-Profit News*. The March issue contained articles by him entitled "A Promising Throne Speech," "Final CPRN Study on Non-Profits Available," "Rigby Replaces McCloskey at CRA," "Strict Tax Rules Incur Penalties for Not-for-Profit," "Voluntary Sector Advocacy Forum Pushing Advocacy Reform," "Scotland Forging Ahead," and "Distribution from Alter Ego Trusts."

In early March, Miller Thomson and Deloitte & Touche co-sponsored a complimentary seminar in Toronto entitled "Legal & Taxation Issues Facing Charities." The seminar included presentations by **Susan Manwaring** of our Toronto office and **Maureen Pappin** of Deloitte & Touche.

Robert Hayhoe of our Toronto office published an article "TCC rejects retail value for charitable art donation" in the *Lawyers Weekly* in early March.

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