MILLER THOMSON LLP

Barristers & Solicitors
Patent & Trade-Mark Agents

CHARITIES & NOT-FOR-PROFIT NEWSLETTER

February 2006

The Charities & Not-for-Profit Newsletter is published monthly 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.com.

CRA "GIFTS AND INCOME TAX" GUIDE UPDATED TO CLARIFY FAIR MARKET VALUE DETERMINATION

Amanda Stacey
Toronto
416.595.8169
astacey@millerthomson.com

CRA has released an update to its "Gifts and Income Tax" Guide (P113) in which the Agency clarifies how the fair market value of a gift is to be determined.

The updated Guide states that "fair market value" is usually the highest dollar value one can obtain for a particular piece of property in an open and unrestricted market, between a willing buyer and a wiling seller who are acting independently of each other. There are, however, certain situations where the fair market value of a particular property will be deemed to be less than the actual fair market value of the property as described above. The fair market value of donated property is required in order to determine the "eligible amount" of a gift. The "eligible amount" is the amount by which the fair market value of the gifted property exceeds the amount of any advantage, if any, received or receivable for the gift.

Determining the fair market value of gifts in kind (i.e., gifts of property other than cash) is not a simple process, and donors and qualified donees must consider a variety of factors when determining the fair market value. The updated Guide suggests that donors and qualified donees obtain one or more appraisals to establish the fair market value of the property being donated. The appraised fair market value is used to calculate the eligible amount of the gift (unless the deemed fair market rules apply). The appraised fair market value will also be used in the calculation of any capital gain or loss to the donor from donating the property.

Where the property to be donated is personal property, real property or intangible property, the CRA encourages donors and qualified donees to contact a professional appraiser, valuator or other individual who is accredited in the field of valuation. That individual should be knowledgeable about the principles, theories and procedures of the applicable valuation discipline and follow the *Uniform Standards of Professional Appraisal Practice*, or standards of the profession. Also, the Guide recommends that such person be knowledgeable about and active in the marketplace for the specific property. The chosen appraiser must be independent. In other words, he or she should not be associated with the donor, the qualified donee, or another party associated with the purchase, sale, or donation of the property. The individual should also be knowledgeable about the elements of a properly prepared and credible valuation report. The Guide notes that if a recipient has difficulty finding an independent appraiser, or if this would involve unreasonable expense, a qualified employee of the qualified donee accepting the gift can appraise it if the fair market value is $1,000 or less. If the circumstances are very unusual, that employee can appraise the donation if the fair market value is just over $1,000.

The question of how to value gifts-in-kind is often vexing one. While the CRA provides some guidance, as discussed above, valuation approach questions often require the application of judgment. With our extensive experience as advisors to charities (and of representing charities in CRA audits), Miller Thomson charity tax lawyers can often assist charities with valuation approach questions.

Inside

HOLDING COMPANY STOCK DONATIONS

Arthur Drache
Toronto
416.595.8681
adrache@millerthomson.com

As almost any fundraiser will attest, the biggest single positive change to encourage giving in recent years has been the special rules which give preferential treatment to the donation of listed securities to charities (other than private foundations). The ability to claim tax relief on the fair market value while including just one half of the normal amount for capital gains purposes on one's tax return resulted in a quantum leap on multi-million dollar donations in Canada.

But there is a somewhat anomalous situation. Shares of private holding companies do not qualify for the tax break even if all the assets of the holding company are in fact qualifying shares. This issue was raised with Finance just after the tax breaks were first announced but there has never been any longer-term concerted push to deal with the matter.

While this "problem" may seem esoteric, the fact of the matter is that a lot of people hold their portfolio investments in private companies and many see this as an impediment to using the tax incentive.

There are three basic reasons why a lot of tax planners suggest keeping portfolio holdings in such a company.

- Often the company is used as a vehicle for an estate freeze and properly structured, family members can share in the growth of the portfolio, something that cannot be done when the shares are held personally.
- In some provinces where there are high probate fees, the use of a private company to hold the portfolio shares along with well-crafted Wills can avoid probate fees on death
- Holding a diverse portfolio within a private company simplifies transmission at death as one can simply transfer the shares of the holding company, obviating the need to re-register all the underlying assets when they are left to other people.

If the idea is to make a cash gift rather than a gift of appreciated shares, the process is simple. The company either pays a dividend or a "bonus" to the shareholder who in turn makes the donation. But if the idea is to transfer appreciated shares, the techniques used are quite different if maximum tax benefits are to be achieved. The same tax benefits as are achieved by a direct gift of public company shares can be achieved by having the company make donations of appreciated listed securities to a qualifying charity. The mechanics are a little more complicated and thus are often misunderstood except by tax advisers.

The following sets out the steps that occur when a private company donates appreciated shares to a qualifying charity:

- The company receives a deduction (not a credit) for the fair market value of the gift. This of course will act as a shelter for the company's other income. The usual five-year carry-forward apply.
- Three-quarters of the gain (the equivalent of the tax-free portion of an individual's gift) is allocated to what is known as the capital dividend account (CDA) (note that when the Conservative promise to exempt all gains comes into play, this will be 100% of the gain). The CDA is a *notional* account for tax purposes and the company's accountant will be keeping track of the amount in the CDA (if the inclusion rate on capital gains realized drops to zero as the Conservatives promised in their campaign, presumably the full amount would be added to the capital dividend account making the planning even more attractive).
- A company can pay out a *tax free* dividend at any time up to the amount which is recorded in its CDA. Thus, the donation sets the stage for the ability to pay tax free dividends in the future. One attractive aspect of this is that if there are multiple shareholders (the spouse or children or even grandchildren), proper planning can direct who receives tax free dividends as opposed to taxable dividends (a benefit such as this is obviously not available where an individual makes a gift of personally owned appreciated shares to the charity).

- Because the value of the company shares will be reduced through the gift of its assets, this will offer some relief to the shareholders in situations where there is a disposition of the shares, either actual or deemed, as at death.

In many cases, the holding company portfolio will include US assets. Because a company can take advantage of the Canada/US tax convention as can an individual, the company could make donations to US 501(c)(3) organizations and receive tax deductions.

Of course, if the company makes the gift, the tax receipt should be issued to the company. That said, given recent CRA statements that "naming rights" are not a benefit to a shareholder, it seems quite clear that there is nothing wrong with the charity giving public recognition to the owner/shareholder for the corporate gift. Thus, if the normal procedure is to thank donors publicly for making gifts of a certain size, the rules seem to allow giving the individual some public credit for the donation. This seems like a minor point but for many potential donors, personal name recognition is important - they don't particularly want to see credit given to the 123456 Ontario Ltd. holding company.

As we noted above, the mechanics sound quite complex and are perhaps best explained to a potential donor by someone who is comfortable with private company taxation. But our experience is that without expert help, many people who hold appreciated listed securities through holding companies believe that they cannot get the tax benefits from the donation of the shares - this is not correct but because the mechanics are not always clear, our experience is that the shareholders shy away from making such gifts. A gentle education process may do wonders.

LOCAL HEALTH INTEGRATION NETWORKS - BILL C-36 - THE ONTARIO GOVERNMENT PROPOSES SWEEPING POWERS OVER CHARITABLE PROPERTY DONATED IN HEALTH CARE SECTOR

Susan Manwaring
Toronto
416.595.8583
smanwaring@millerthomson.com

and

Kathryn Frelick
Toronto
416.595.2979
kfrelick@millerthomson.com

The Ontario government is pushing forward with the enactment of Bill 36 - *An Act to Provide for the Integration of the Local System for the Delivery of Health Services.* This Act proposes sweeping changes to the delivery of health care in Ontario. Included are sections that purport to give the proposed Local Health Integration Networks “LHINs” and the Minister of Health and Long Term Care “the Minister” sweeping powers over charitable property.

Integration Decisions and Orders

Under section 26(1) of Bill 36, a LHIN may, where it is "in the public interest to do so", issue a decision that requires a health service provider (HSP) to, among other things, provide all or part of a service or cease to provide that service or transfer a service to another location or to another entity. As currently drafted, there is no definition or criteria for determining when a decision or order is in the "public interest".

Such a decision may require the HSP, "to do anything or refrain from doing anything necessary" to achieve that decision, **"including to transfer property to or to receive property from another person or entity in respect of the services affected by the decision."** HSPs include hospitals, long term care homes, psychiatric facilities, and home and community care service providers, among others. Some, but not all of these entities may be charities.

Further the Minister may order a HSP to cease operating, amalgamate with one or more HSPs, or transfer all or substantially all of its operations to one or more persons or entities that carry on operations on a not-for-profit basis, subject to several restrictions. In so doing, the Minister can order the HSP to "**take any other action necessary to carry out the order, including to transfer property related to the operations affected by the order."**

Given the broad wording of these provisions, there is a risk that a LHIN or the Minister could try to extend its authority by issuing an integration decision or order directed at charitable property held by a hospital foundation or other HSP-related charity. While LHINs do not have direct authority over foundations and other charitable organizations, under the proposed legislation, the argument would be that their powers extend to HSP-related charitable property held by a foundation. In our view, this position is not currently tenable, nor supported by the legislation.

Part of the confusion may stem from the term "parties", which is broadly defined as "the persons or entities that are subject of the decision". The definition does not appear to restrict "parties" to HSPs. Arguably it should, and foundations could be included by regulation as HSPs. It is unclear what the government will do.

Further, the legislation provides that an HSP that is a party to an integration decision or order may request reconsideration of that decision or order, but this does not extend this right to non-HSP parties. Thus, if a integration decision or order purported to extend to charitable property held by a foundation or charitable organization, the only recourse would be through the court process of judicial review.

Transfer of Charitable Property

Proposed section 30(1) of Bill C-36 states:

> If an integration decision or a Minister's order made under section 28 directs a health service provider to transfer to a transferee property that it holds for a charitable purpose, all gifts, trusts, bequests, devises and grants of property that form part of the property being transferred shall be deemed to be gifts, trusts, bequests, devises and grants of property of the transferee.

The Bill confirms that if the gift is designated for a specific purpose, it shall continue to be so designated, and that subsection 30(1) applies to gifts, trusts, bequests, devises and grants made, before or after the section comes into force.

As drafted, the legislation requires the transfer of charitable property, but does not set out any mechanism in the event that the transferee is unable to use the property for the specified purpose. Where there is a question as to the disposition of the property and whether the specified purpose can be fulfilled, the affected party would be required to bring a *cy-pres* application to the court for a determination of the donor's intentions and how that charitable property is to be used.

We note as well that under the proposed legislation, there is no right to compensation for any loss or damages arising from any direct or indirect action that a Minister or LHIN takes, including an integration decision or a Minister's order. Section 31 confirms that no person or entity is entitled to compensation for any loss or damages arising from the transfer of property, except for the portion of the value of any property that was purchased with non-government funds.

These subsections, taken together with the reintroduction of the proposal (which had earlier been introduced in 1996 and then dropped by the then government) to amend the *Public Hospitals Act* regulations to require hospital foundations to disclose financial statements to the Minister and LHIN, have sent a chill through the health care fundraising community. Many are concerned that donors will not be interested in donating in such an environment.

This is a particularly interesting approach for the government to be taking at a time when overall funding for hospitals is under great pressure and governments expect hospitals to fundraise their "local share" for capital redevelopment projects, which may be up to 50% of the overall cost. We wonder if government officials are aware of how often a donor will ask for a provision in a deed of gift to guarantee the return of the donation if a government decides to direct the use of donated funds.

Donors often have clear reasons why they make their gift and clear ideas as to how a gift should be used. One only has to consider the many faith-based hospitals which adopt an approach to the provision of health services consistent with a particular religious tradition, to understand the concerns a donor may have about funds being transferred without the donor's input. One wonders why the government would want to interfere with some of the most successful fundraising initiatives in the country.

The proposed legislation raises a number of other questions:

1. Section 6(5) of Bill 36 provides that a LHIN cannot make charitable donations except as authorized by this Act, and further cannot apply for charitable registration without obtaining the approval of the Minister. Further, the LHIN requires the approval of both the Health and Finance ministers, if it wants to receive money and assets from any person or entity except the Crown, and/or act in association with a person who conducts fundraising activities or programs for the network.

Does this provision prevent a local foundation obtaining assistance from the LHIN and support for the fundraising it is doing in favour of the particular hospital supported by the Foundation?

2. LHINs are Crown Agents and Bill 36 confirms that the property of a LHIN is not charitable property, but also contemplates that a LHIN (with appropriate approvals) may apply for registration as a charity.

Do the decisions of the LHIN or the Minister have to take into account the regulations charities are required to meet under the *Income Tax Act* (Canada)?

3. Integration decisions and orders that require the transfer of charitable property can be made by the LHIN or the Minister of Health and Long Term Care, respectively.

Does the Attorney General of Ontario appreciate that its jurisdiction over charitable property has been removed to independent non-profit organizations? Currently the Office of the Public Guardian and Trustee has administrative oversight over the use of charitable property in Ontario. Will the PGT continue to assume that role?

The Courts have long held the guardianship power over charitable property in Ontario. We support it remaining with the Courts and the removal of these powers from the Bill.

The Standing Committee is currently holding public hearings into Bill 36 and it is possible that some of these issues may be addressed. Should the legislation be adopted, there are a number of strategies that foundations and other charitable organizations will need to explore to ensure donor confidence and to satisfy donors that donations will be used in accordance with the donor's intentions. For example, ensuring that there is clear gift documentation setting out any restrictions to be placed on future gifts will be critical to future endeavours.

We will be following the progress of this draft legislation closely and will be pleased to assist organizations in determining the potential implications of this legislation and to develop strategies to manage the risk.

UNEXPECTED APPLICATION OF ONTARIO ADVERTISING RESTRICTIONS

Robert Berry
Guelph
519.780.4636
rberry@millerthomson.com

Does your organization receive funds from the Province of Ontario or administer funds for or on behalf of the province? If you do and you give recognition or credit to the Province in your advertising or publications you should review the new *Government Advertising Act* (the "Act") and have a meeting with your funding body representatives.

Certain sections of the Act came into force on November 21, 2005, with the balance coming into force on January 30, 2006. As set out in the explanatory note to the Act, the Act provides for a review by the Auditor General of specified types of advertising by government offices. Charitable organizations or not-for-profits may be caught by the provisions of the Act and the organization's advertising or printed material subjected to review by the Auditor General to determine if it meets the standards defined in the Act.

Specifically, section 2 of the Act provides that no government office shall publish, display or broadcast any advertisement that a government office proposes to pay to have published in a newspaper or magazine, displayed on a billboard or broadcast on radio or television unless such advertisement meets the standards required by the Act as determined by the Auditor General.

Section 3 provides that no government office shall distribute any printed matter that a government office proposes to pay to have distributed by bulk mail or by another method of bulk delivery unless such printed matter meets the standards required by the Act as determined by the Auditor General.

Similarly, section 4 applies to 'such additional classes of messages as may be prescribed that a government office proposes to convey to the public' although at the moment there are no such prescribed messages.

How does the Act apply to a non-government organization? The Province appears to be taking the position that if an organization is advertising or sending out printed matter by bulk mail that gives credit or recognition to the Province of Ontario for its financial support of the organization or a program of the organization, then such advertisement or printed matter fits the "proposes to pay" criteria, and is therefore subject to the Auditor General's review and approval. The Act does not define "proposes to pay" but for now it seems to be government policy that if the government's name or logo is attached then the advertisement or printed material is subject to review. Time will tell whether or not the government retreats from this position or extends it even farther to apply even if there is no credit or recognition given to the government.

The Act sets out in section 6 the standards by which an advertisement or printed matter caught by the Act is to be judged by the Auditor General, the decision of whom is final. The advertisement or printed material must:

- be a reasonable means of achieving one or more of the following purposes:
    - informing the public of current or proposed government policies, programs or services available to them;
    - informing the public of their rights and responsibilities under the law;
    - encouraging or discouraging specific social behaviour, in the public interest; or,
    - promoting Ontario or any part of Ontario as a good place to live, work, invest, study or visit or to promote any economic activity or sector of Ontario's economy;
- include a statement that the advertisement or printed matter is paid for by the Government of Ontario;
- not include the name, voice or image of a member of the Executive Council or a member of the Assembly;
- not be partisan (defined as an item, a primary objective of which is to promote the partisan political interests of the governing party);
- not have as a primary objective the fostering of a positive impression of the governing party or a negative impression of a person or entity who is critical of the government; and,
- must meet such additional standards as may be prescribed (of which there are currently none).

If the Auditor General determines that the advertisement or printed material does not meet the standards then the government office is prohibited from publishing, displaying, broadcasting or distributing the advertisement or printed matter. There are no specific penalties prescribed by the Act for failure to comply. However, one can anticipate that if an organization that receives funding from a government ministry may be required as a condition of continued funding, not to publish, display, broadcast or distribute the advertisement or printed matter, particularly if, as current government policy seems to be, such advertisement or printed material is giving credit or recognition to the government, without the Auditor General's approval. One can also anticipate that if the organization continues to publish or distribute without such approval its funding may be cut off.

The Management Board Secretariat News Release dated December 11, 2003, quotes Management Board Chair Gerry Philips as saying: "This bill fulfills a pledge we made to restore public faith in our democratic institutions and make government more accountable, transparent and fiscally responsible." One may question whether or not giving the Auditor General a review function over the advertising and printed matter of any organization receiving government funding accomplishes the goal of restoring faith in public institutions. Perhaps the process by which an organization receives government funding needs to be vetted to restore public faith and make government more accountable, transparent and fiscally responsible, rather than how those organizations, once vetted and approved to receive funding, spend their advertising dollars. Substituting the review by the Auditor General for the work of volunteers and staff of non-government organizations seems other than fiscally responsible.

CRA NOW ACCEPTS GIFTS TO US RELIGIOUS SCHOOLS

Robert Hayhoe
Toronto
416.595.8174
rhayhoe@millerthomson.com

As discussed in an article in the September 2005 issue, we recently became aware that the Canada Revenue Agency was refusing to apply Information Circular IC 75-23 *Tuition Fees and Charitable Donations paid to Privately Supported Secular and Religious Schools* (see http://www.cra-arc.gc.ca/E/pub/tp/ic75-23/README.html) to situations involving gifts to US-based religious schools. We understand that the CRA has now abandoned its earlier position and accepts that gifts to US religious schools can form the basis for a charitable donation tax credit under Article XXI(6) of the Canada-US Tax Treaty. As discussed in more detail in the previous article, Article XXI(6) provides that gifts by a Canadian resident to a US charity are treated as gifts to a Canadian registered charity to the extent that the Canadian taxpayer has US source income.

IC 75-23 provides that when an amount is paid as tuition to a religious school, the difference between the total amount paid as tuition and the amount paid that relates to secular schooling can be treated as a charitable donation. We understand that in some cases CRA had refused to permit individuals with US source income to treat any portion of tuition paid to US religious schools as a charitable donation. However, after the publication of the October 2005 article, we were contacted by a senior tax practitioner who confirmed that his personal notice of objection, filed on the basis that the religious portion of tuition paid to his child's US religious school was a gift that could form the basis of a charitable donation tax credit pursuant to Article XXI(6), had been accepted. The CRA Appeals Directorate has now reassessed this senior tax practitioner to accept his tax credit claim.

WHAT'S HAPPENING AROUND MILLER THOMSON LLP

The January issue of *Canadian Not-For-Profit News*, edited by **Arthur Drache**, contained the following articles by him: "Unintended Consequences II", "Russian NGO Law Proposal Draws International Attacks", "Private Members Think about Voluntarism", "Bar and Accountants Recommend Clarification of Donation Issue", "Bad Idea Abandoned by Finance", "The Year to Come: 2006", "What is Top Talent Worth?", as well as "CRA Now Accepts Gifts to US Religious Schools", by **Robert B. Hayhoe** and "Federal Law May Require Charities to Register as Lobbyists" by **Ivan Fleischmann**.

The January 1 issue of *The Canadian Taxpayer* contained **Arthur Drache's** article "FCA Reverses Tax Court's Art Flip Decision."

Robert Hayhoe published (with Patrick Boyle) an article "The Clergy Residence Deduction Case: Denominational Appointments and Cross-Appointments", in the January 2006 issue of the *CCCC Bulletin* published by the Canadian Council of Christian Charities.

The January issue of *Charitable Thoughts* included "Debts Incurred by Charitable Foundations - CRA Policy Change" by **Amanda Stacey** as well as "Disclosure of Donor Records to CRA" by **Daniel Kiselbach** and **Jacqueline King**.

Arthur Drache spoke to the Financial and Estate Planning Council of Montréal in January on "Charities and Estate Planning - Opportunities and Pitfalls".

In January, **Sandra Enticknap** taught at a 2 day workshop for Continuing Legal Education on "Advanced Estate Administration Matters".

MILLER THOMSON LLP CHARITIES & NOT-FOR-PROFIT GROUP

Toronto/Markham

Jennifer E. Babe	416.595.8555
Rachel L. Blumenfeld	416.596.2105
Arthur B.C. Drache, Q.C., C.M.	416.595.8681
Mark R. Frederick	416.595.8175
Kathryn M. Frelick	416.595.2979
Robert J. Fuller, Q.C.	416.595.8514
Eugene J.A. Gierczak, P.Eng.	416.596.2132
Robert B. Hayhoe	416.595.8174
Hugh M. Kelly, Q.C.	416.595.8176
Jacqueline L. King	416.595.2966
Peter D. Lauwers	905.415.6470
Susan M. Manwaring	416.595.8583
Nora F. Osbaldeston	416.595.8680
Rosanne T. Rocchi	416.595.8532
Martin J. Rochwerg	416.596.2116
Amanda Stacey	416.595.8169
Brenda Taylor (Corp. Services)	905.415.6739
Steven L. Wesfield	416.595.8606
Michael J. Wren	416.595.8184

Vancouver

Sandra L. Enticknap	604.643.1292
Martin N. Gifford	604.643.1264
Alan A. Hobkirk	604.643.1218
Peter M. Jarvis	604.643.1273
Eve C. Munro	604.643.1262
Donald H. Risk, Q.C.	604.643.1207

Calgary

William J. Fowlis	403.298.2413
Sandra M. Mah	403.298.2466
Gregory P. Shannon	403.298.2482

Edmonton

Bruce N. Geiger	780.429.9774
Dragana Sanchez-Glowicki	780.429.9703

Waterloo-Wellington

Frank O. Brewster	519.822.4680
Stephen R. Cameron	519.579.3660
Lorelei Graham	519.822.9578
John J. Griggs	519.579.3660
J. Jamieson K. Martin	519.579.3660
Richard G. Meunier, Q.C.	519.579.3660
Robin-Lee A. Norris	519.822.4680

Montréal

Ronald Auclair	514.871.5477
Richard Fontaine	514.871.5496
Marie-Michele Lavigne	514.871.5490
Lysane Tougas	514.871.5435
Louise Tremblay	514.871.5476

www.millerthomson.com