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CHARITIES & NOT-FOR-PROFIT NEWSLETTER

December 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.

Inside

MILLER THOMSON ADDS ANOTHER DEDICATED CHARITY AND NOT-FOR-PROFIT SPECIALIST

We are pleased to announce that Kate Campbell has joined our Charities and Not-for-Profit group as a mid-level associate. Kate, who has a background as a tax lawyer with another major national law firm, will be practising in our Toronto office. While in law school, she was awarded the Carswell National Tax Prize, the Martin J. Rochwerg Prize in Tax, Estates and Trust Law, and the Centennial Prize in Lawyering Skills.

THE 2007 MILLER THOMSON FOUNDATION NATIONAL SCHOLARSHIP PROGRAMME

Since the creation and launch of its scholarship programme in 1995, the Miller Thomson Foundation has awarded a total of $1,750,000 to 1,750 promising students pursuing post-secondary education in Canada. The purpose of the Miller Thomson Foundation scholarships is to encourage the attainment of higher education goals by top students in Canada who have demonstrated high academic achievement and made meaningful contributions to their schools and communities. One of Miller Thomson's core philosophies has always been the dedicated contribution of its lawyers to the wellbeing of the communities it serves, through support of public and social service programmes.

In 2007, 200 National Scholarships are available, each winner receiving $1,000 towards post-secondary education within Canada. To obtain an application form and further information about the National Scholarship, please visit our website at www.millerthomson.com and then link to MT Foundation, or e-mail Lesley Lawson, Executive Director of the Miller Thomson Foundation, at llawson@millerthomson.com.

UPDATE ON FLOW THROUGH SHARES AND CHARITABLE DONATIONS

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In the August 2006 issue of our Charities and Not-for-Profit Newsletter, we wrote about the advantages of donating existing flow-through shares to charities given the exemption from tax on capital gains introduced by the federal government on gifts of listed public securities in May of this year. Most flow-through shares are publicly listed securities and a gift to a registered charity after the renouncement of the resource expenses can be quite attractive to the investor/donor.

Since publishing the article, we have seen more activity in the flow-through share market. Promoters are highlighting the attractiveness of donating flow-through shares to charity at the time they are promoting the investment to investors.

Canada Revenue Agency officials have confirmed that on its face there is nothing offensive about the fact that a publicly listed flow-through share may be gifted to charity and subject to the exemption from capital gains tax. However, action is required where the flow-through share promotion addresses the gifting of the charitable donation from inception and uses the value of the charitable donation tax credit as an incentive to investors to invest in the flow-through share.

Charities should be mindful of the timing of the ability to liquidate the shares. Where shares may be gifted at a time which is significantly earlier than the date of liquidity, the recipient charity should obtain independent valuations of the share value to ensure that the appropriate amount is being recorded on the charitable donation tax receipt. The effective date of an irrevocable direction to gift in the future may also impact the date and value to be reflected on the tax receipt.

On another note, flow-through shares are generally exempt from the requirement that a tax shelter identification be obtained. However, a flow-through share that is promoted along with an irrevocable gift to charity could, depending on how it is structured, require a tax shelter identification number. These structures may involve gifting arrangements and could therefore be caught by section 237.1 of the *Income Tax Act*.

Gifting of flow-through shares remains an attractive way to structure charitable giving for donors. That said, the tax advantages associated with these new structures have not yet been tested. Charities should be careful and be mindful when approached with these gifts to obtain appropriate advice.

CRA ON VALUATION DATE FOR BEQUESTS

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Bequests of property made by a Will are often received by a charity long after the Testator dies as it takes time to administer an estate. The value of a gift in kind, such as shares, can vary during this time period. The issue arises as to whether a charity should value the gift at the date of the bequest or when the gift is actually received. The valuation impacts the charitable receipt and the cost amount of the property on the charity's books. Fortunately, this valuation issue should not impact the charity's disbursement quota.

The *Income Tax Act* deems a gift by Will to be made immediately before the person dies. This provision allows the charitable donation tax credit to be claimed in the deceased person's final T1 tax return. The Canada Revenue Agency confirmed in Registered Charities Newsletter No. 27 that this provision requires the recipient charity to issue a receipt for the fair market value of the gift *at the time immediately before the death*. This is so even though the property is not be received by the charity until many months (or even years) after the date of death.

SPITZER V. GRASSO: AN UPDATE

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Readers will recall that our June 2004 issue noted the potential impact on conflict of interest and executive compensation, of a proceeding brought by the Attorney General of the State of New York against the former Chair of the New York Stock Exchange. Since that time, there have been a number of intermediate proceedings (as one might expect where many millions of dollars are at stake). Some of those proceedings involved a series of motions for summary judgment, that is, a judgment without any further trial and evidence. In a recent series, five motions were applications to dismiss Mr. Grasso's claims against the Stock Exchange and others; five motions were applications by Mr. Grasso and others to strike out portions of the initial claim; and one was a motion by the Attorney General for summary judgment on the initial claim itself. (These were only some of the claims that Attorney General Spitzer had made against Mr. Grasso, and some of Mr. Grasso's defences, and claims against the Stock Exchange and others).

In the middle of October 2006, New York Supreme Court Justice Ramos handed down a decision that, among other things, required Mr. Grasso to return part of his compensation package that could amount to as much as 100 million dollars. At the same time, the Judge rejected a number of Mr. Grasso's claims for further entitlement as a result of his severance from the Stock Exchange. In the course of his 72 page reasons, Judge Ramos was quite critical of the actions and non-actions of Mr. Grasso:

> Mr. Grasso turns the law of fiduciaries on its head when he maintains that it would have been "improper" for him to advise the Board about his [pension]. Not only does nothing preclude Mr. Grasso as CEO from making sure that the [Compensation] Committee had all of the information it needed to make an informed decision, it was his affirmative duty. Indeed, the Committee relied upon Mr. Grasso and his staff to prepare the packets of information it needed for each meeting. … Who, but Mr. Grasso, would have directed the staff to prepare such information for the Compensation Committee?
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> …
>
> Mr. Grasso's duty is to be fully informed and to see to it that the Board was fully informed. He failed in this duty.
>
> …
>
> That a fiduciary of any institution, profit or not-for-profit, could honestly admit that he was unaware of a liability of over $100 million, or even over $36 million, is a clear violation of the duty of care. The fact that it was a liability to an insider (Chairman and CEO) is even more shocking and a clear violation of the duty of loyalty.

This case is still far from over. On Mr. Grasso's application, the New York Appeals Court has stayed these orders of Judge Ramos pending the hearing of Mr. Grasso's appeal of the orders. At this time, there is no indication as to when the appeal will be heard.

Several key issues are still to be decided by the court:

> whether Judge Ramos should be removed from the case (as Mr. Grasso has demanded) on the grounds in part because an executive search firm, working on the Judge's behalf, had contacted the New York Stock Exchange in 2002 (when Mr. Grasso was still its chairman) and in 2003 (a month after he had left) about the Judge joining its Board of Directors;
>
> whether Mr. Grasso's compensation and benefits are unreasonable, and therefore under the New York statute, unlawful; and
>
> whether certain other payments were invalid because the Board of Directors did not properly authorize and approve those payments.

On the basis of what has been decided so far (and bearing in mind that the Appeal Court could take a different view from that of the trial judge), it appears that the conduct of Mr. Grasso fell short of what is expected from someone in his position. The relatively harsh language used by Judge Ramos in assessing Mr. Grasso's performance as an officer and director perhaps demonstrates, as much as or more than the repayment requirement, that the courts (at least in New York) continue to expect much from those who have a fiduciary duty.

CORNWALL INQUIRY FINDS ROMAN CATHOLIC DIOCESE "PUBLIC INSTITUTION"

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Following years of controversy about the rumoured existence of a child sex abuse ring in Cornwall, the Government convened the Cornwall Public Inquiry under Commissioner Justice G. Norman Glaude. The purpose of the Inquiry was to "inquire into and report on the institutional response of the justice system and other public institutions, including the interaction of that response with other public and community sectors…"

The Commissioner was asked to rule on whether the Roman Catholic Diocese of Alexandria-Cornwall is a "public institution" within the mandate of the Commission. He held that it was:

> In my view, the question of whether the Diocese of Alexandria-Cornwall is a "public institution" within the terms of the mandate is a matter of pure statutory interpretation. "Public institution" is not defined in the Order in Council nor in the governing statute.

...

> I believe that the Diocese of Alexandria-Cornwall is a public institution involved in the response to allegations of abuse in the Cornwall area and is allegedly one of the most significant players in this matter.

As a public institution, the response of the Diocese to allegations of historic abuse can be examined. In addition, recommendations may be made for how the Diocese, together with other public institutions, can and should response to such allegations in the future.

> Having said that, the fact remains that this should not and cannot be looked upon as an investigation of the Church, its doctrine, or its beliefs. Rather the Diocese is the corporate entity, the human resources arm of the Roman Catholic Church, which employed the priests who worked in this area. As such, the mandate will be applied to the Diocese in the same way as it is being applied to other public institutions involved in this inquiry.

Precisely what the Commission has in mind for the examination of public institutions is, on the face of this ruling, a mystery. What greater level of scrutiny will be experienced by the Diocese of Alexandria-Cornwall as a result of this ruling than it would face if it were instead classified as an organization that is part of the "other public and community sectors" referred to in the Order in Council? How intrusive will the Commission be?

This startling result is arguably contrary to the Order in Council, the *Public Inquiries Act* itself, and likely also runs afoul of freedom of religion that is protected by s. 2(a) of the *Canadian Charter of Rights and Freedoms*, since the Diocese is a religious organization. The implications of characterizing a religious organization (or any other charity that is not controlled by the government) like the Diocese as a "public institution" are troubling in the abstract, and may become more or less so depending on how the Commissioner applies the decision for practical purposes. The "slippery slope" implications of the intrusiveness promised by the Commissioner's decision for the privacy and autonomy of religious organizations and other charities are frightening.

The Diocese did not seek judicial review of the decision, and charities generally may yet rue the day.

TAX COURT REJECTS STAMP CATALOGUE VALUATION

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The English translation of the Tax Court of Canada's late 2004 decision of *Robichaud* v. *the Queen* was released recently. The case involved the valuation of stamps donated to charities.

Robichaud, an accountant, started an amateur stamp collection hobby a number of years prior to the appeal. While most collectors collect stamps based on countries, themes or other identifiable characteristics, Robichaud's collection initially had no particular focus.

According to the decision, Robichaud was also interested in tracing his family heritage. In tracing his family tree, he learned that some of his ancestors were of Amerindian origin. In trying to bring his two hobbies together, Robichaud donated certain batches of stamps to the Fondation Amerindienne Tecumseh (the "Foundation") in 1989, 1990 and 1991. He had purchased the stamps from a friend and co-worker, Jean Allaire. The donations were made at the same time as the purchase.

The Foundation issued three receipts in the amounts of $2,089.70, $5,189.81 and $6,870.00 to Robichaud. The Foundation relied on the "Scott" stamp catalogue to determine the fair market value ("FMV") of the stamps donated. No other source was utilized to obtain the fair market value of the donated stamps.

Despite being an accountant, Robichaud testified that he had very little tax knowledge because his work was more related to administration than to accounting. That said, he did prepare his own tax returns as well as for family members and friends.

Robichaud was re-assessed for the three years in which he donated the stamps - 1989, 1990 and 1991.At issue in the appeal of the re-assessment was the proper determination of the FMV of the stamps. The

appellant, calling no other evidence than his own testimony, argued that the Scott catalogue was a definitive source on the matter. However, the respondent called an expert in philately who testified that the Scott catalogue is by no means determinative of the value of stamps.

The court accepted the expert's determination of the FMV of the stamps and stated that the three batches of stamps donated had the following FMV:

Batch	FMV
I	$280
II	$433
III	$671

The court found that "the FMV is generally the price that a buyer free from any constraint, specific emotion or need is prepared to pay to acquire the property from its owner equally free from any pressure or influence of any kind".

It went on to say that there is "no sufficient guide, catalogue or register for determining the FMV of property". This sentence casts a wide net as the court did not limit itself to guides, catalogues or registers to determine the FMV of stamps.

The court seemed reluctant to attach any weight to catalogues or guides such as the Scott catalogue and said that at most, they are a "reference that prevents one from making totally arbitrary decisions". The court offered the following factors to consider in determining the FMV of stamps, some of which may apply to other types of property:

- Condition of the property;
- Purity; and
- Authenticity.

In the end, the court concluded that Robichaud was naïve in referencing a guide such as the Scott catalogue as an authoritative report on the FMV of the stamps that he donated to a charity. As an accountant, he should have understood that. However, the court was not prepared to say that his actions amounted to gross negligence as the Minister of National Revenue had argued. As such, the court found that it was not a situation in which it was justified to levy penalties against Robichaud. The assessments were referred back to the Minister of National Revenue for reconsideration and reassessment based on the court's finding of the FMV of the property in question.

This case demonstrates that charities and donors must be aware of the source and basis for determining the FMV of the property transferred. It is not necessarily sufficient to rely on a published guide outlining some potential "price" for cars, coins, hockey cards, etc. The Minister of National Revenue, with the support of the Tax Court of Canada, requires more. While the court did not specify exactly what it needs for a proper determination of the FMV of property, it did provide a few pointers. Firstly, where available and appropriate, the opinion of an expert would be very helpful as it was in the case at hand. Secondly, the factors outlined above can be useful depending on the type of property in question. Thirdly, relying solely on a guide or catalogue is insufficient and should only be used as a bare minimum resource. Finally, the FMV should be the price a buyer would be willing to pay free from any constraint, specific emotion or other influence.

UPDATE ON CRA AUDITS

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Receiving notice that your organization is to be the subject of an audit by the Charities Directorate is a chilling experience. Why have we been chosen? What are they looking for? What have we done wrong? Are we going to lose our charitable status? These are but a few of the questions that go through the minds of administration and Directors when advised that they are about to be audited.

The Charities Directorate on Charity Audits

Elizabeth Tromp, the Director General of the Charities Directorate spoke to the Southern Alberta Charities Section of the Canadian Bar Association in October, 2006. She hopes that the introduction of intermediate sanctions and the increased budget for conducting audits is not seen as a threat by the charities sector. She believes these enhanced compliance measures will strengthen the accountability of the charitable sector and thereby maintain the confidence which donors have in the integrity of that sector.

Audits will be conducted on about 1% of the registered charities over the next year. The audit selection triggers include third party complaints; specific problem areas which the Charities Directorate has identified as needing attention; and random selections. A few organizations will come through an audit with a clean result. However, most have problems with varying degrees of seriousness and complexity. The historical results suggest that about 25% of the organizations audited have problems with their record keeping; another 25% have difficulties because of incomplete information; 10% are "offside" because of gifting to non-qualified donees; 10% have lost touch with their original charitable purpose, the balance relate to a variety of causes.

This degree of non-compliance is not, according to Ms. Tromp, the result of an overly complex regulatory regime. However, a concerted effort at educating the sector as to its ability to achieve and maintain compliance is clearly important. The audit is, among other things, one tool in that education process.

The consequences of an audit include any of the following (not necessarily in sequential order):

(a) No change for the organization;

(b) An education letter issued by the Charities Directorate to the organization;

(c) A compliance agreement signed by the organization with the Charities Directorate;

(d) Sanctions;

(e) Revocation.

Ms. Tromp indicated that about 50% of the audits result in education letters. An education letter identifies the lack of compliance by the organization and seeks to assist by setting out why the organization was "off side", and what requirements need to be met to avoid non-compliance. These are generally used where there has been some clear lack of compliance on the part of the organization but it has been determined that it is either a one time event or is something based on a lack of knowledge. It is hoped that the letter will educate the organization and prevent further breaches.

Compliance agreements are used when the organization appears to have been unaware of its obligation. The obligation which has been missed is viewed as a significant "oversight" by the Directorate and there may be some concern about a lack of internal control. To ensure future compliance an agreement is entered into with the organization which will be monitored.

Where the chosen sanction is a fine, the organization will be directed to pay the fine to another charity, in keeping with the overall goal that charitable funds remain in the sector rather than generate revenue for the Charities Directorate.

Revocation is reserved for the most serious and flagrant breaches.

Steps may be taken to post information about compliance by an organization on the Directorate website. Donors would be able to search and be informed about the status of a particular organization from a compliance perspective. Given the small percentage of organizations which are audited and the high degree of non compliance identified in that small sample it is questionable whether that kind of information is all that useful. Donors might mistakenly believe the absence of mention on the website means the organization is compliant when in fact it merely means they have not been audited.

Ms. Tromp ended her speech by stressing that if it is your turn to receive a visit from the auditors panic should not be your first reaction. If there has been a genuine effort to comply on a timely basis, the consequences of minor transgressions should not be worrisome.

The Reality on Charity Audits

Unfortunately, the CRA Charities Directorate audit program is no longer under the direct control of the Charities Directorate, but has been moved to local CRA Tax Services Office tax avoidance auditors. Many of these auditors seem to have the view that taxpayers under audit are generally non-compliant (otherwise, they

would not have been chosen for audit . . .) and should be reassessed. They bring this mentality to charity audits. Many are new to auditing charities and may not yet have developed much background.

As a result, tax avoidance auditors are proposing revocation of charitable registration in all sorts of situations that never would have resulted in a revocation proposal in prior years. While it seems that it will be possible in some of these situations to avoid revocation by negotiation with CRA, this situation suggests that the views of CRA Charities Directorate headquarters on the educational purpose of charity audits are not making their way to the field auditors.

A charity facing an audit should obtain legal advice prior to the audit. It is possible to survive an audit - if the audit is approached properly and if compliance is ensured to the full extent possible.

WHAT'S HAPPENING AROUND MILLER THOMSON LLP

The *Calgary Real Estate News* published the article "Charitable registration appeal denied by Canada Revenue Agency" by **Esmail Bharwani,** and quotes **Robert Hayhoe** and **Amanda Stacey**.

The December issue of *Canadian Not-For-Profit News*, edited by **Arthur Drache**, contained the following articles by him: "The Year in Review", "2002 Proposals May Soon Be Enacted", "FCA Slaps Down Another Registration Appeal", "MPs Show Backbone over Museum Cuts", "FCA Reverses Redeemer Foundation Decision", and "Clear as Mud".

The Canadian Taxpayer included "A Tale of Two Credits" by **Arthur Drache** in November.

On November 17, 2006 **Sandra Enticknap** presented on "Maximizing the Use of Agency Agreements" at the Pacific Business and Law Institute sponsored "Charities Law and Practice: Effective Tips and Tools to Ensure Your Charity's Success" conference in Vancouver.

The December 1, 2006 issue of the *Lawyers Weekly* included an the article "FCA decision addresses what is charitable under the *Income Tax Act*" by **Susan M. Manwaring**

The December 5, 2006 issue of *The Canadian Taxpayer* edited by **Arthur Drache** included the article "Foreign Trust and Charity Legislation Finally on Road to Enactment" by **Arthur Drache**.

On December 5, **Rachel Blumenfeld** presented on "Gifts in Kind" to the Professional Advisory Committee of the Jewish Foundation of Greater Toronto. **Martin Rochwerg**, as chair of the Committee, presented a tribute to Wolfe Goodman.

Arthur Drache spoke on "The Year in Review" at a continuing legal education seminar sponsored by the Charities and Not-for-Profit Law Section of the Ontario Bar Association in Toronto on November 21.

Miller Thomson's Charities and Not-for-Profit practice hosted late November client receptions in London and Toronto at which **Arthur Drache** spoke on "The Year in Review".

Arthur Drache spoke on "Adventures in Charitable Giving: Tales From the Trenches" at an early December event sponsored by the Victoria Community Foundation.

Robert Hayhoe and **Susan Manwaring** presented on "Tax Update" at an Association of Fundraising Professionals conference in Toronto in November.

Robert Hayhoe presented on "Legal Issues" at a CCI/Canada Conference in November.

Robert Hayhoe presented in November at the Annual Conference of the Canadian Tax Foundation in Toronto on "Charities Update 2006".

Rachel Blumenfeld and **Martin Rochwerg** presented on "Gift Planning Strategies" at the December 13th Breakfast session of the York Region Professional Advisory Council in Markham.

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