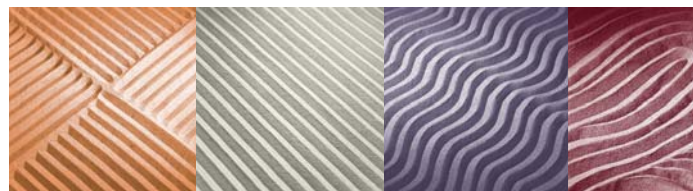




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CHARITIES & NOT-FOR-PROFIT NEWSLETTER

January 2008

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.

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MILLER THOMSON CALGARY CHARITY AND NOT-FOR-PROFIT WORKSHOP SERIES

Miller Thomson's national Charity and Not-for-Profit law group is hosting a workshop series at the Calgary Chamber of Commerce. Workshops are scheduled February 20, 7:30a.m. to 10:15a.m. and March 17, 8:30a.m. to 1:15p.m.. The seminar topics will cover a wide variety of topics of interest to our sector.

More details are available on our website at www.millerthomson.com or by contacting Becky Leis at bleis@millerthomson.com or 403.262.0007.

TAX COURT DENIES APPLICATION FOR POSTPONEMENT OF SUSPENSION OF INTERNATIONAL CHARITY ASSOCIATION NETWORK

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On January 3, 2008, the Tax Court of Canada dismissed an application by the International Charity Association Network ("ICAN") to postpone the suspension of its tax-receipting privileges. CRA had audited ICAN in 2006-07, presumably suspecting that ICAN was operating solely as a part of a tax shelter program. On November 21, 2007, the Minister of National Revenue suspended ICAN's authority to issue tax receipts on the basis that:

- (i) ICAN failed to maintain proper books and records, and
- (ii) ICAN failed to provide records or provide access to records to the tax authority.

The suspension was for one year commencing on November 28, 2007. On December 3, 2007, CRA also issued a notice of intention to revoke ICAN's charitable registration.

On November 23, 2007, ICAN filed a Notice of Objection to the suspension and applied for a postponement of the suspension pending the outcome of its Notice of Objection. ICAN argued that it had attempted to comply at all times with both the record-keeping rules, and with rules regarding cooperation during an audit. It claimed that it had responded to questions from the auditor and had made records available for review by CRA.

The Court held that an application for postponement of a suspension requires that a charity satisfy the three-part test for interlocutory injunctions set out by the Supreme Court of Canada in *RJR-MacDonald v. Canada* (A.G.). The charity must demonstrate:

- (i) that there is a serious question to be tried;
- (ii) that it would suffer irreparable harm if denied the injunction; and
- (iii) that the balance of convenience favoured granting the injunction.

The Court found that ICAN had raised a serious question to be tried. However, the Court was influenced by the seriousness of the claims made against ICAN and considered CRA to have a strong case. It noted, for example, that in 2006 ICAN had issued receipts totalling approximately \$464 million (by comparison, in 2006 the United Way of Greater Toronto issued receipts totalling only \$95 million). The Court drew further attention to the scale of ICAN's operations in noting that CRA proposed to reassess 12,177 donors who participated in the program in 2005 and 22,674 donors who participated in 2006.

On the second issue, the Court held that ICAN had not proven that it would suffer irreparable harm if its receipting powers were suspended. It emphasized in particular a lack of supporting evidence from ICAN's member agencies on how their ability to operate would be affected by ICAN's suspension. Finally, the Court held that the balance of convenience favoured CRA. It stated that the public confidence would be harmed if CRA were unable to administer the charities provisions of the *ITA* and ensure compliance in the public interest. For these reasons, the Court dismissed ICAN's application.

In the course of its decision, the Court noted that

... even a charity with the most altruistic and humanitarian activities is subject to the *Act's* requirements to maintain proper books and records and permit the CRA to examine these documents to ensure that such activities are being carried out properly and within the confines of the *Act*. The quality, quantity or nature of charitable activities of a registered charity do not trump the requirements of the *Act*. Status as a registered charity is conditional on the charity observing statutory requirements granting its status.

This passage underscores that even the most reputable charity will still be required to comply with the record-keeping provisions of the *ITA*. This passage may well be cited by courts in assessing the record-keeping compliance of charities. Charities should seek to ensure that they meet these requirements, as this decision suggests that they may find little leniency from CRA or the courts if their record-keeping practices do not comply.

Analysis: an unfortunate precedent

The Court's decision in *ICAN* sets an unfortunate precedent with respect to applications for postponement orders. The Court interpreted the test for postponement orders so as to make it exceedingly difficult for charities to obtain what should be a relatively accessible order. This interpretation fails to appreciate the evidentiary constraints affecting charities, who must respond quickly to a notice of suspension in order to preserve their essential receipting abilities. The decision is out of synch with the purpose for which postponement orders were introduced.

Postponement orders were introduced as a counterbalance to CRA's suspension power, which was introduced along with several other intermediate sanctions for non-compliance in the 2004 Federal Budget. The purpose of these sanctions was to enable CRA to take a more nuanced approach to sanctioning non-compliant activities than was previously available under the former system, in which de-registration was the only penalty available. These measures were intended to provide forms of sanction that would encourage charities to correct any practices that were non-compliant with the *ITA*, but in such a way that would allow them to continue operating. De-registration was recognized as a severe penalty that should only be used as a last resort.

As a corollary to the new emphasis on corrective measures and discretionary sanctions, charities must be given readily accessible recourse when faced with such sanctions, particularly as the sanctions become more severe. This was emphasized by the Voluntary Sector Initiative Joint Regulatory Table, whose report was the foundation for the new sanctions. Postponement applications, as a measure of recourse against CRA's relatively severe suspension power, should therefore be construed broadly and made readily available to charities.

This point is underscored by recognizing the difficulties that charities face when applying for postponement of a suspension. The charity is at a procedural disadvantage given that it has limited time available to seek postponement before the suspension takes effect (seven days from mailing of the notice). Thus, it has only limited time to gather evidence and prepare a response to the substance of CRA's allegations. Any decision on an application for postponement should be mindful of the limited time available to the charity to respond, and should temper the charity's evidentiary burden accordingly. Unfortunately, this did not occur in *ICAN*.

The effects of this procedural difficulty seem to have directly impacted the result in this case, as the Court's decision appears to have been influenced by its assessment of the substantive cases put forward by ICAN and CRA. For example, despite finding that there was a serious question to be tried, the Court was clearly concerned over the seriousness of CRA's allegations and the picture of ICAN's activities painted in the affidavit of CRA's auditor. Furthermore, in assessing whether ICAN had demonstrated that it would suffer irreparable harm, the Court emphasized the lack of evidentiary materials submitted in support of ICAN's argument that its member agencies would suffer if ICAN's receipting privileges were suspended. This raises concern that all CRA must do is make serious allegations of non-compliance, and on the strength of these allegations it will be very difficult for the charity to meet the test for a postponement order.

Furthermore, in assessing the balance of convenience, the Court appears to have misunderstood CRA's constitutional role in finding that the public interest would be harmed if CRA were unable to enforce compliance with the *Income Tax Act*. CRA, as a federal agency, does not regulate the conduct of charities for the good of the general public. Its proper role as regulator of charities is limited to its role as a taxing authority. It is beyond CRA's constitutional jurisdiction to attempt to protect the public interest by controlling charities' behaviour or by restraining general abuses by charities. This role belongs to provincial authorities. Thus, the Court should not have based its decision on concerns about harm to the general public that would result if CRA's ability to suspend were "handcuffed."

For all these reasons, we view the decision in *ICAN* as an unfortunate development. A charity's ability to issue receipts is vital to its ability to operate. A year-long suspension, in practical terms, spells death for most charities. It is thus crucial that charities be able to continue issuing receipts to have any chance of surviving even if they are not ultimately de-registered. However, this decision suggests that charities may have considerable difficulty in staving off this fate if CRA decides to suspend their receipting ability. The decision in *ICAN* fails to appreciate that the purpose of postponement orders demands that they be readily obtainable to a charity faced with a suspension notice. It is hoped that courts in the future will decide such applications along different lines.

As a final point, some attention should be given to the note of Associate Chief Justice Rip, in his conclusion to the decision. Rip A.C.J. noted that a charity seeking to have its suspended receipting privileges restored faces a lengthy delay before the situation can be resolved. He noted that postponement orders deal with only a portion of the suspension, and that a charity's only other option is to challenge the suspension by filing an appeal. The appeal process, as Rip A.C.J. noted, could take as long as a year before the appeal is determined. For these reasons, Rip A.C.J. suggested that Parliament should consider a summary procedure by which a charity would be permitted to contest a suspension.

We submit that precisely such a summary procedure has been developed by Parliament and should have been employed in this case. Once a charity has been mailed a Notice of Suspension, there is a 7-day delay before the suspension begins. A charity should be able file its notice of objection to the suspension as well as its application for postponement within this 7-day period. Given the seriousness of the effects of suspension on a charity's ability to function, a preliminary postponement (usually for a month) should generally be granted so as to give the charity time to prepare a full response to the suspension *without the suspension having already taken effect*. We suggest that this procedure is possible under the current legislation and would answer the concerns set out in Rip A.C.J.'s note.

GIFTS MADE IN CONTEMPLATION OF DEATH

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Introduction

We usually think of a gift by an individual to a registered charity as, either, a gift made during the individual's lifetime (*inter vivos*), or, a gift made upon death by Will (testamentary) or direct designation of the beneficiary of life insurance, RRSPs or RRIFs. But, at common law, another form of gift is recognized, a *donatio mortis causa* ("DMC") or gift made in contemplation of death.

Canada Revenue Agency's View of a *Donatio Mortis Causa*

On December 19, 2007, Canada Revenue Agency ("CRA") published its view on the timing of a hypothetical DMC made by an Ontario individual to a registered charity (CRA Views 2007 - 02284115). CRA expressed the three requirements for a valid DMC as follows:

1. the gift must have been made in contemplation of, though not necessarily expectation of death;
2. the subject matter of the gift must have been delivered to the donee; and
3. the gift must have been made under such circumstances as to show that the property is to revert to the donor if the donor should recover (this condition is sometimes put somewhat differently, and it is said that the gift must be made under circumstances showing that it will only take effect on the death of the donor).

In CRA's view, a DMC is a gift subject to a condition precedent, the death of the donor. CRA concluded that the gift would not be considered complete for tax purposes until the donor's death. The reasoning was stated as follows:

Where a gift is subject to a condition precedent, it is our view that even where the transfer to a registered charity is made voluntarily without expectation of return and the other essential requisites of a gift are satisfied, the gift cannot be completed before that condition is satisfied.

In CRA's view, the donor of a DMC would be entitled to a deduction in computing tax payable, to the extent permitted by subsection 118.1(3), for his or her final taxation year.

Contrary View

Arguably, however, CRA's analysis and conclusion are incorrect. The three requirements set out by CRA for a valid DMC reflect in substance the requirements as set out by Lord Russell of Killowen in the often-quoted 1896 English case of *Cain v. Moon*. Lord Russell did not analyze whether it was more appropriate to state requirement number 3 as a gift subject to reversion or as a gift which would take effect on the death of the donor. However, Lord Russell did in fact apply the gift "subject to reversion" language in the case being considered. An analysis of exactly what is meant by the third requirement is necessary however for the purpose of determining the time when a charitable deduction for a DMC is available.

All elements for a valid DMC are, in fact, complete within the donor's lifetime. Many cases turn upon whether the donor has taken sufficient steps to effect "delivery" of the gift to the recipient during the donor's lifetime. A more accurate description of a DMC is that it is a present gift subject to a condition subsequent that the property will revert to the donor should the donor recover or expressly revoke the gift. In determining whether the deceased made an effective DMC of his Corvette to his common-law spouse the day before he died (thereby preventing it from being an asset of his estate), the Nova Scotia Court of Appeal in a 1986 case determined that the deceased had not met the test of "making an immediate gift of the car in contemplation of his imminent death subject to revocation in the event of his recovery". A somewhat analogous situation is where an individual settles property on a trust for the benefit of another but reserves to himself or herself the right to revoke while the he is living and has capacity. The trust is in place from the outset and does not await the death or incapacity of the settlor before taking effect.

Even if a DMC is considered as a gift conditional upon death, the effective time of the gift is not at death as CRA interprets it. As described in *Mellows: The Law of Succession* (5th edition) at page 520:

A *donatio mortis causa* may ... be defined as a gift made by a person in his lifetime with the intention that it should take effect only on his death. The gift is therefore conditional upon death, but once the condition is satisfied it takes effect retrospectively, from the date the gift was made.

If the effect were otherwise then a DMC would be unsuccessful in removing the property from the deceased's estate and would therefore be subject to the terms of the deceased's Will and subject to probate fees.

If CRA's analysis is correct that the timing of the gift is not until the donor has died, then a charitable deduction would only be available to the estate and not to the donor in his or her final taxation year. Gifts made by Will and gifts by virtue of life insurance, RRSP or RRIF designation are, of course, deemed by subsections 118.1(5), (5.1) and (5.3) to be made by the individual immediately before the individual's death. A comparable deeming provision is not available for *donationes mortis causa*.

PRINCIPLES FOR GOOD GOVERNANCE

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In October 2007, the Panel on the Nonprofit Sector, an independent group of nonprofits in the United States, released a document entitled *Principles for Good Governance and Ethical Practice: a Guide for Charities and Foundations*. The following summarizes the recommendations that are applicable to Canadian charities and nonprofits. Note that while there are legal requirements to undertake some of these recommendations, others are simply considered best practices. A full copy of the report is available at www.nonprofitpanel.com

Legal Compliance and Public Disclosure

1. A charitable organization must comply with all applicable federal laws and regulations, as well as applicable laws and regulations of the states and the local jurisdictions in which it is based or operates.
2. A charitable organization should have a formally adopted, written code of ethics with which all of its directors or trustees, staff and volunteers are familiar and to which they adhere.
3. A charitable organization should adopt and implement policies to ensure that all conflicts of interest, or the appearance thereof, within the organization and the board are appropriately managed through disclosure, recusal, or other means.
4. A charitable organization should establish and implement policies and procedures that enable individuals to come forward with information on illegal practices or violations of organizational policies. This "whistleblower" policy should specify that the organization will not retaliate against, and will protect the confidentiality of, individuals who make good-faith reports.
5. A charitable organization should establish and implement policies and procedures to protect and preserve the organization's important documents and business records.
6. The board of directors should ensure that the organization has adequate plans to protect its assets - its property, financial and human resources, programmatic content and material, and its integrity and reputation - against damage or loss. The board should review regularly the organization's need for general liability and directors' and officers' liability insurance, as well as take other actions necessary to mitigate risks.
7. A charitable organization should make information about its operations, including its governance, finances, programs and activities, widely available to the public. Charitable organizations also should consider making information available on the methods they use to evaluate the outcomes of their work and sharing the results of those evaluations.

Effective Governance

8. A charitable organization must have a governing body that is responsible for reviewing and approving the organization's mission and strategic direction, annual budget and key financial transactions, compensation practices and policies, and fiscal and governance policies.
9. The board of a charitable organization should meet regularly enough to conduct its business and fulfill its duties.
10. The board of a charitable organization should establish its own size and structure and review these periodically. The board should have enough members to allow for full deliberation and diversity of thinking on governance and other organizational matters. Except for very small organizations, this generally means that the board should have at least five members.
11. The board of a charitable organization should include members with the diverse background (including, but not limited to, ethnic, racial and gender perspectives), experience, and organizational and financial skills necessary to advance the organization's mission.

12. The board should hire, oversee, and annually evaluate the performance of the chief executive officer of the organization, and should conduct such an evaluation prior to any change in that officer's compensation, unless there is a multi-year contract in force or the change consists solely of routine adjustments for inflation or cost of living.
13. The board of a charitable organization that has paid staff should ensure that the positions of chief executive officer, board chair, and board treasurer are held by separate individuals. Organizations without paid staff should ensure that the positions of board chair and treasurer are held by separate individuals.
14. The board should establish an effective, systematic process for educating and communicating with board members to ensure that they are aware of their legal and ethical responsibilities, are knowledgeable about the programs and activities of the organization, and can carry out their oversight functions effectively.
15. Board members should evaluate their performance as a group and as individuals no less frequently than every three years, and should have clear procedures for removing board members who are unable to fulfill their responsibilities.
16. The board should establish clear policies and procedures setting the length of terms and the number of consecutive terms a board member may serve.
17. The board should review organizational and governing instruments no less frequently than every five years.
18. The board should establish and review regularly the organization's mission and goals and should evaluate, no less frequently than every five years, the organization's programs, goals and activities to be sure they advance its mission and make prudent use of its resources.
19. Board members are expected to serve without compensation, other than reimbursement for expenses incurred to fulfill their board duties.

Strong Financial Oversight

20. A charitable organization must keep complete, current, and accurate financial records. Its board should receive and review timely reports of the organization's financial activities and should have a qualified, independent financial expert audit or review these statements annually in a manner appropriate to the organization's size and scale of operations.
21. The board of a charitable organization must institute policies and procedures to ensure that the organization (and, if applicable, its subsidiaries) manages and invests its funds responsibly, in accordance with all legal requirements. The full board should review and approve the organization's annual budget and should monitor actual performance against the budget.
22. A charitable organization should not provide loans (or the equivalent, such as loan guarantees, purchasing or transferring ownership of a residence or office, or relieving a debt or lease obligation) to directors, officers, or trustees.
23. A charitable organization should spend a significant percentage of its annual budget on programs that pursue its mission. The budget should also provide sufficient resources for effective administration of the organization, and, if it solicits contributions, for appropriate fundraising activities.
24. A charitable organization should establish clear, written policies for paying or reimbursing expenses incurred by anyone conducting business or traveling on behalf of the organization, including the types of expenses that can be paid for or reimbursed and the documentation required. Such policies should require that travel on behalf of the organization is to be undertaken in a cost-effective manner.
25. A charitable organization should neither pay for nor reimburse travel expenditures for spouses, dependents or others who are accompanying someone conducting business for the organization unless they, too, are conducting such business.

Responsible Fund-Raising

26. Solicitation materials and other communications addressed to donors and the public must clearly identify the organization and be accurate and truthful.
27. Contributions must be used for purposes consistent with the donor's intent, whether as described in the relevant solicitation materials or as specifically directed by the donor.
28. A charitable organization must provide donors with receipts, in accordance with legal requirements.
29. A charitable organization should adopt clear policies, based on its specific ... purpose, to determine whether accepting a gift would compromise its ethics, financial circumstances program focus or other interests.
30. A charitable organization should provide appropriate training and supervision of the people soliciting funds on its behalf to ensure that they understand their responsibilities and applicable federal, state and local laws, and do not employ techniques that are coercive, intimidating, or intended to harass potential donors.
31. A charitable organization should not compensate internal or external fundraisers based on a commission or a percentage of the amount raised.
32. A charitable organization should respect the privacy of individual donors and, except where disclosure is required by law, should not sell or otherwise make available the names and contact information of its donors without providing them an opportunity at least once a year to opt out of the use of their names.

WHAT'S HAPPENING AROUND MILLER THOMSON LLP

The January 2008 *Canadian Taxpayer* contained "Tax Shelter Charity Publicly Sanctioned" by **Arthur Drache**.

The December 2007 *Canadian Not-For-Profit News* contained "Economic Statement has Little for Non-Profit Sector", "Newfoundland and New Brunswick Create Sectoral Responsibility for Minister", "Portrait Gallery Saga Continues", "Donation Statistics", "Update on Gifts Made by Her Majesty", "Tax Relief for Donations a Matter of Fairness" and "Degree Course in Philanthropy" by **Arthur Drache**.

Susan Manwaring and **Rachel Blumenfeld** spoke on "Developments in Planned Giving: Tips and Traps" at a joint meeting of the London Estate Planning Council and Canadian Association of Gift Planners-London Roundtable on January 21st.

Arthur Drache spoke in mid-January to a meeting of the Society of Trust and Estate Practitioners in Ottawa on "Recent Developments in the Law of Charity".

Kate Lazier spoke on "Reputation and Mission Risk" and **Hugh Dyer** spoke on "Managing the Risk of Being an Employer - Legislation Every New Employer Should Know" at the McIninch Symposium on Risk Management on January 18, 2008.

The 2007 substantive update to the *Charities Taxation, Policy and Practice* Thomson-Carswell looseleaf service was released in December, 2007. The textbook is the only current Canadian charity tax text - **Arthur Drache** and **Robert Hayhoe** are two of its three co-authors.

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