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CHARITIES & NOT-FOR-PROFIT NEWSLETTER

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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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FURTHER AMENDMENTS TO LEGISLATION TO IMPLEMENT EXEMPTION ON GAINS FOR GIFTS TO PRIVATE FOUNDATIONS AND EXCESS BUSINESS HOLDINGS RULES

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In our October 2007 issue, we informed readers that draft legislation incorporating the extension of the exemption from tax on capital gains of publicly-listed securities to private foundations along with the rules to implement the excess business holdings regime was tabled by the Government for comment.

We applauded the capital gains relief but expressed concerns about the nature of the excess business holdings rules. We also confirmed that many were making representations to Finance, including the Canadian Association of Gift Planners, the Canadian Bar Association - Charities and Not for Profit section and Philanthropic Foundations Canada, to demonstrate why the rules proposed could and would have inappropriate application in certain scenarios.

Consistent with this government's desire to be seen as "getting things done", the Minister of Finance has taken the next step towards implementing the measures contained in the draft legislation by tabling the Notice of Ways and Means Motion in the House of Commons on November 13. It was hoped that the Notice of Ways and Means Motion would include changes to reflect the concerns brought to the attention of the Department of Finance about the excess business holdings rules. Unfortunately, it does not.

That said, it appears that the representations may have had some impact. In his press release the Minister states:

> As a result of consultations with private foundations, the Government intends to further review the excess corporate holdings rules in order to provide relief in respect of unlisted securities held on March 19, 2007 and to consider the treatment of corporations wholly owned by such foundations. Minister Flaherty indicated the Government is moving ahead with the legislation at this time, in advance of the conclusion of this review, in order to ensure that the new rules providing a capital gains tax exemption on the donation of listed securities to private foundations are enacted as soon as possible.

It appears therefore that the Government intends to review and perhaps amend the new rules - at some point in the future. This is consistent with the way this Government has handled other pieces of tax legislation since it has been in office (*e.g.*, the new qualifying dividend rules). Unfortunately, moving forward with legislation that is problematic is not, in our view, an effective way to implement tax policy. We hope that the sector will work to try and ensure the Minister follows through on his promise to revisit these rules. We continue to believe that Finance officials have not had a full opportunity to consider and understand the ramifications of the introduction of the rules. We hope the government decides to take the time required to study the impact of the excess business holdings rules before they proceed any further.

The one positive note in this new draft of the legislation is that it does away with the double penalty for private foundations that inadvertently were found offside the new rules. In the original legislation private foundations with existing holdings were provided with limited transition rules to allow them to come on-side which was a positive initiative. However, the rules then went on to state that they would not be eligeble for the exemption from capital gains tax on gifts of publicly listed securities during that transitional period. In other words the government was taking away with one hand the relief it gave with another. Thankfully, the latest draft removed that provision and gifts can be made under the new rules during the transition period.

Miller Thomson will keep you posted on changes as they are announced and would be pleased to assist with any questions or concerns about the rules as currently drafted.

FEDERAL GOVERNMENT RELEASES DRAFT LEGISLATION PROVIDING NEW INCENTIVE FOR CORPORATE DONATIONS OF MEDICINE

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On October 2, 2007, the Federal Government released draft legislation creating an incentive for corporations to donate drugs and medicine for use abroad. The draft legislation implements proposals set out in the 2007 Budget. The incentive is designed to encourage corporations to participate in international programs to combat disease in the developing world.

Gifts by corporations of property held in inventory are already eligible for a charitable donation deduction equal to the amount by which the fair market value of the donated property exceeds the value of any benefit received in return. Proposed paragraph 110.1(1)(e) will allow a special additional deduction for certain gifts of medicine out of inventory, generally equal to the lesser of the cost of the donated medicine and 50% of the amount by which the fair market value exceeds that cost.

In order to qualify for this treatment, the gift must meet certain criteria set out in proposed subsection 110.1(8). The gift must be made out of the inventory of the corporation. If made before October 1, 2007, the gift must consist of medicine. If made after October 1, 2007, the gift must consist of medicine that qualifies as a drug under the *Food and Drugs Act* (Canada) (the “Act”) and used for the treatment, diagnosis or disinfection of humans - it cannot be a food, cosmetic, device, or veterinary drug. It furthermore cannot be a natural health product - that is, a homeopathic or traditional medicine - as defined under the *Natural Health Products Regulations*.

The drug must generally meet the requirements under the *Food and Drugs Act*, which set out standards for the manufacture, storage and sale of drugs, as well as restrictions on labelling and packaging. Donors will not be able to rely on the exemption from these requirements in subsection 37(1), which permits the export of drugs not meeting these requirements provided that they are clearly marked for export and are certified by their manufacturer not to contravene the laws of their destination market. To qualify for the deduction in paragraph 110.1(1)(e), the donated medicine must meet the requirements of the Act if read without reference to subsection 37(1).

The corporation must make the gift to a registered charity in Canada subject to a direction that the gift be used in charitable activities outside Canada. The recipient charity must also have received a past disbursement under an international development assistance program of the Canadian International Development Agency. A list of partner organizations is provided through CIDA's website, as well as information on which of these have received disbursements. The new deduction will be available for gifts made on or after March 19, 2007.

Miller Thomson's charity and pharmaceutical lawyers can assist in identifying qualifying donees and ensuring that gifts meet the necessary requirements for this deduction.

NEW CRA SPLIT RECEIPTING RULING

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The CRA recently released a ruling which deals with the split receipting rules and shows how they can be used in complex situations which go far beyond a simple transfer to a charity.

The background is not only complicated but is likely unique. Yet the facts demonstrate how some very tricky legal situations can be overcome by sophisticated planning and the cooperation of all parties.

Many years ago, the grandmother of the individuals who requested the ruling conveyed title to a piece of property (the "Property") to a charity (the "Charity") on terms which required the Charity to use the Property for specific purposes. If the Charity failed to use the Property for the specified purposes, its ownership would terminate and the property would revert to the donor or her heirs (this is often referred to as a condition subsequent).

As a matter of real property law, the interest of the Charity in the Property is known as "fee simple determinable", and on the occurrence of a "reverter event" (that is, if the property were not being used for the intended purpose), that interest would be terminated, the donor would become the owner in fee simple of the property, and all rights of the Charity would be extinguished. As the donor had died, the individuals in question would take her place under her Will. As such, the individuals acquired a vested interest in the rights as tenants-in-common on the death of their father (the "Rights"). Each individual owns an undivided percentage interest in the rights.

The parties now say that the specified purposes for which the deceased had conveyed the property to the Charity can no longer be attained as a result of changes in circumstances. The Charity wishes to continue to carry out the same objectives as far as possible in accordance with the original wishes of the deceased and in cooperation with the individuals.

The Charity wishes to be able to dispose of the Property, free of potential uncertainty and possible loss of its interest in the Property upon the occurrence of a Reverter Event as a result of a failure to continue to use the Property for the uses set out in the original deed. After lengthy negotiations with respect to the status and effect of the Rights, and with a view to resolving matters, the individuals and the Charity have entered into the letter agreement under which, subject to obtaining satisfactory rulings or opinions from the CRA, each individual will sell his or her interest in the rights to the Charity for an amount that is less than its fair market value.

When the Charity acquires the Rights, they will merge with the fee simple and be extinguished by operation of law, with the result that the Charity will thereafter own the Property in fee simple, and the individuals will have no further Rights in respect of the Property, other than the right to be paid the purchase price under the sale agreement. In summary, on closing, all of the Rights will be extinguished, since they will have been acquired by the Charity and will have merged with the interest currently owned by the Charity.

There was a determination of what the rights were worth. Under the arrangement proposed, the individuals sell their rights to the charity which will then sell the property to an arm's length purchaser. The Charity then would use part of the money received to pay off the individuals for the rights which they sold. The payment however was not to be equal to the full value of the rights transferred.

The purposes of the proposed transactions were:

i) to reach an orderly resolution of the differences between the individuals, on the one hand, and the Charity, on the other hand, with respect to the status of the rights and their effect on the ownership of the Property;

ii) to permit the Charity to proceed with the sale of the Property, without further regard to the uncertainty that arises under the Rights and to establish a endowment for the purposes, and on the terms, described in the letter agreement; and

iii) to allow the individuals to receive partial consideration for a sale of the rights.

The transactions are designed to give the individuals a combination of proceeds from a sale of the Rights and tax credits for donations of the excess amount.

The basic issue was whether the payment by the charity of less than fair market value for the Rights generated a gift by the individuals which could be receipted under the split receipting rules.

Despite the fact that the split receipting rules have not as yet been enacted, the CRA ruled as follows:

> The excess of the fair market value of an Individual Sale Portion over the total amount of the advantage, as defined in proposed subsection 248(32), that the Individual receives, obtains or enjoys will, provided that the total amount of such advantage does not exceed 80% of the fair market value of the Individual Sale Portion, be the eligible amount of a gift for purposes of proposed subsection 248(31) and the Individual may include such eligible amount in determining his or her total charitable gifts, for purposes of subsection 118.1(1) for the year in which the donation occurs if an official receipt containing prescribed information is filed as required by subsection 118.1(2).

Even very active charities and lawyers with busy charity practices might go decades before seeing a similar fact situation but the imaginative solution to get around mutual problems and the happy tax result (which could not have been achieved before the split receipting rules were announced) is a fascinating read for those who are faced with knotty problems of this ilk from time to time.

For those who might want to read this lengthy ruling for themselves, the CRA citation is 2007-0227171R3.

NEW ONTARIO PRIVATE CAREER COLLEGES ACT MAY CATCH NON-PROFIT ORGANIZATIONS

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Ontario's *Private Career Colleges Act*, 2005, provides an extensive regulatory scheme governing private career colleges. An entity that would not consider itself to be an educational institution may be caught by this legislation if it provides a program that prepares students for employment.

In addition to registering, a private career college must contract with students in writing, implement refund policies, establish complaint procedures, as well as, follow policies on advertising, insurance, trust accounts and fulfill other requirements. The Act establishes a training completion insurance fund to which registered colleges must pay premiums. In general, such colleges are required to pay annual premiums of 0.875% of the college's annual gross revenue from vocational programs until the value of the fund reaches 3% of the total gross revenues from all vocational programs in Ontario. The fund also levies additional premiums and surcharges.

Both non-profit and for profit organizations providing vocational programs to students for a fee are required to register and have their programs approved. A vocational program includes instruction in the skills and knowledge required in order to obtain employment. The word "vocation" is defined very broadly in the legislation, but there are a few exceptions within the fields of health, the arts, recreation and sports. Instruction for work in a religious vocation is also excluded, whether or not program is provided by a religious organization. However, a religious institution delivering a non-religious vocational program such as lay counselling may still need to register.

Programs offered exclusively to students under the age of 18, programs which cost less than $1000, and programs under 40 hours in length are also exempt from registration. Universities, colleges and other schools regulated under similar legislation do not need to register. Similarly, professional development and skills upgrading courses do not require approval under the legislation as these programs are directed at individuals who already have experience in a vocation.

Despite these exemptions the legislation's broad wording captures many organizations offering employment training. It is possible for an organization to apply for the pre-screening process to obtain comfort that the legislation does not apply. In our experience, the Ministry has treated these requests in a sensible manner.

Failure to comply with the Act may result in a fine of $25,000 for individuals and $100,000 for corporations. Additionally, each director and officer of the corporation who knowingly concurs in the commission of an offence is liable to fine of up to $25,000 or term of imprisonment of up to one year or both. Such fines are not to be levied more than one year after the contravention first came to the knowledge of the Superintendent.

Organizations which provide employment training should consider whether they need to register. The lawyers at Miller Thomson can assist organizations with this legislation.

AFFINITY FRAUD: IN THE CIRCLE OF TRUST

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The Canadian Securities Administrators recently announced the findings of a new national study on investment fraud and its social impact estimates. The study found that over one million adult Canadians have been the victim of an investment scam and that half of these victims were introduced to the fraud through an existing relationship of trust. Trusting relationships fostered between group members are an important part of why people join and participate actively in charitable and not for profit groups. Increasingly, however, fraudsters are infiltrating religious, new immigrant and cultural groups to find trusting victims for their investment scams. The Canadian Securities Administrators have been working hard to inform the public about how to avoid being the victim of "affinity fraud".

What is affinity fraud?

Affinity fraud is a kind of investment scam that preys upon members of identifiable communities such as religious, cultural, or professional groups. Typically, a fraudster becomes involved in a small, trusting community where they build relationships with the members of the group. Once they have gained the trust of the group members, they defraud them of their money by convincing them to invest in fraudulent schemes. Fraudsters will often target a respected member of the group and through them attempt to meet and gain the trust of other group members to convince them to invest in their schemes.

Affinity fraud investment schemes usually involve a "pyramid" or "Ponzi" scheme where a part of the money from new investors is used to make payments to earlier investors. Investors will often receive a payment within a short period of time, giving them some confidence in the fraudster and encouraging them to increase their investment. The flow of money gives the illusion of a high return and builds credibility for the scheme, helping to lure more investors. Inevitably, the supply of new investors dwindles and the scheme collapses and the investors lose their money.

Why are religious and cultural groups particularly vulnerable?

Religious and cultural groups are particularly vulnerable to affinity fraud. Why? The answer is trust. Investment fraudsters succeed by gaining the trust of their victims. In affinity fraud, fraudsters take advantage of the trusting relationships fostered by close communities to gain easy access to this trust.

Another factor making these groups particularly vulnerable is that there are often low levels of reporting where frauds occur within close communities. In many cases, the strong affiliation the victims feel with the group means that they will choose not to report their loss to the authorities but rather try to deal with the matter within the group. Victims can also feel a sense of shame that they trusted the fraudster or may be reluctant to report someone they may still see as 'one of their own.' Regulating authorities often have difficulty accessing and informing potential investors within close communities and language or cultural barriers may make it difficult for group members to access the information they need to protect themselves.

What are the regulatory authorities doing to try to prevent affinity fraud?

As it often occurs within close communities, affinity fraud is one of the toughest forms of investment frauds for regulatory agencies to combat. Authorities have reacted to the recent pervasiveness of affinity fraud by trying to educate group members about investing safely. The Canadian Securities Administrators recently published a pamphlet entitled "Protecting your finances: How to avoid investment frauds and scams" which warns group members of the dangers of affinity fraud. The B.C. Securities Commission is also expanding its approach by combating affinity fraud where it occurs. Since 2003 they have financed the work of 'God's Fraud Squad', a successful program delivered in the Vancouver Fraser Valley by two pastors committed to informing church groups about investing wisely.

What steps can people and organizations take to protect themselves?

Affinity fraud can be hard to recognize as fraudsters will often spend years building relationships with group members before they start suggesting investment opportunities. There are steps, however, that investors can take to protect themselves:

- Be suspicious of investment opportunities that are to be kept secret from anyone or that are only available to members of a particular group.
- Never make an investment solely on the recommendation of people you know through an organization, religious or ethnic group you belong to. These people may already be the unknowing victims of a scam. The fact that they have received a return on their investment does not mean that you will or that they won't eventually lose their money.
- Be careful of any investment advisor who emphasizes a religious connection. You should hold religious financial planners to the same standards as you would anyone else.
- Beware of anyone who might try to tell you that faith-based investments are not regulated. Most investments are regulated by securities law and must be registered before they can be sold. Be suspicious of someone who suggests that an investment will eventually be listed on a stock exchange.
- Beware of any new member of your group who begins talking about high-return investment opportunities.
- Never make an investment you don't understand. Don't be afraid to ask questions and make sure your questions are answered. Scams often rely upon the victim's silence.
- If it sounds too good to be true, it probably is! No investment is entirely without risk so be cautious if you are promised very high returns with no risk.
- Never accept a verbal contract. Always get written documentation of any transactions and be suspicious if the investor is unable to provide a written prospectus. Fraudsters do not like to leave written documentation of their work.
- Never pre-sign blank forms and never sign anything before reading it carefully. If documents are hard to understand, ask questions and get professional third party advice.
- Take notes of every contact you have with an investment advisor and do your research.
- Don't let yourself be pressured into making a quick investment decision. Fraudsters often present investment opportunities as a one-time opportunity and often pressure investors into making quick decisions before the opportunity is gone.

Affinity fraud is a serious crime and anyone who suspects that affinity fraud is occurring within their group or fears that they might have been a victim of a fraudulent investment scheme should contact their provincial securities regulator. The website of the Canadian Securities Administrators is: http://www.csa-acvm.ca/home.html.

WHAT'S HAPPENING AROUND MILLER THOMSON LLP

The October 15 Canadian Fundraiser quoted from **Hugh Kelly's** article "Reform of Ontario Not-for-Profit Corporation Law Consultation Paper #2" from the September issue of this newsletter.

The October *Canadian Not-For-Profit News* contained "Charity Examiners Get It Wrong Again", "Parliament Prorogued", "When IRS Steps into Governance, "Registration Getting Tougher", "Ontario Consultation Paper on Corporations", "Cabinet Shuffle Marginal to Third Sector", "Charity Tax Shelter Warnings", "CRA Roadshows", "Donating Bell Shares May Be Attractive" by **Arthur Drache** and "When IRS Steps into Governance, Can CRA Be Far Behind?" by **Hugh M. Kelly, Q.C.** .

Esmail Bharwani published an article entitled *Supreme Court of Canada rules amateur soccer association not a charity* in the October 18, 2007 issue of Calgary Real Estate News.

On November 1, 2007, **Hugh Kelly** presented "Legal Issues in Education in Ontario" to student-teachers enrolled at the Ontario Campus of Niagara University College of Education.

Robert Hayhoe and **Kate Lazier** published an article entitled "Charities must maintain control of activities undertaken abroad" in the November 9, 2007 issue of *The Lawyers Weekly*.

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