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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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SUCCESS IN THE SUPREME COURT OF CANADA FOR IMAGINE CANADA

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Susan Manwaring and **Kate Lazier** of Miller Thomson LLP were part of the team of top charity lawyers who donated their time and effort to intervene successfully on behalf of Imagine Canada at the Supreme Court of Canada in *A.Y.S.A. Amateur Youth Soccer Association* v. *Canada Revenue Agency*. The appeal was only the third time in the past 50 years that the Supreme Court of Canada has undertaken a review of the question of what constitutes a charity under Canadian law.

The case involved an organization established to promote amateur soccer to youth in Ontario. The Canada Revenue Agency (CRA) had refused to register the organization as a charity on the basis that the promotion of sport is not a charitable purpose under the common law. The organization appealed this decision to the Federal Court of Appeal. In its decision, the Federal Court of Appeal concluded that because Parliament had previously conferred charity-like benefits under the *Income Tax Act* to Registered Canadian Amateur Athletic Associations (RCAAAs), it could be presumed that Parliament intended to exclude sports organizations from qualifying as charities. For this reason the Court of Appeal went on to conclude that it was not necessary to comment on whether the common law of charity had evolved to the point that the promotion of sport per se was an accepted charitable purpose.

A.Y.S.A successfully applied to the Supreme Court of Canada for leave to appeal this decision. It was critical to the charitable sector that the decision be appealed because generally members of the sector were of the view that the approach and reasoning of the Federal Court of Appeal was wrong and could potentially have other limiting consequences for the sector. In particular, Imagine Canada and others were concerned that the reasoning of the Federal Court of Appeal could result in the Canada Revenue Agency arguing that other legislative provisions under the *Income Tax Act* granting charity-like benefits to certain arts organizations and groups providing housing for seniors restrict the definition of charity under the common law, and/or could preclude organizations with similar purposes but which did not technically meet the definitions in those specific sections, from qualifying as registered charities.

Imagine Canada applied successfully to intervene in the appeal to the Supreme Court of Canada. Its primary interest was to argue that the Court should dismiss the reasoning of the Federal Court of Appeal and most importantly to confirm that the determination of whether an organization was established for charitable purposes was to be done by reference to and application of the evolving common law.

Laird Hunter of Richards Hunter in Edmonton argued the case on behalf of Imagine Canada. The Supreme Court of Canada agreed with Imagine Canada's arguments, holding that the provision giving special tax treatment to RCAAAs does not limit the scope of what is charitable, absent an explicit intention to the contrary. The Court was sympathetic to the proposition that organizations promoting fitness should be considered charitable. While the Court held that the purposes and activities of the AYSA sports organization were not charitable, the Court made clear that organizations that use sport as a means of achieving their charitable purposes are entitled to continue to put forward applications for registration as charities and have them duly considered for possible registration. This decision was important as it preserved the existing law of the charities and confirmed that organizations that use sport as a means of achieving their charitable purpose are not effectively precluded from seeking charitable status by the existence of the RCAAA regime.

QUEBEC MUNICIPAL TAX EXEMPTIONS

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In 2000, amendments were made to Quebec's *Municipal Tax Act* which introduced a reform to the conditions, criteria and procedures for property owners and occupants seeking municipal tax exempt status. The reform was in part a consequence of the ongoing phenomenon of downloading from the provincial government to municipalities. The tightening of the rules with respect to granting tax exemptions was one way to allow municipalities to help meet their ever increasing budgetary requirements. Further, it was felt at the time that the manner in which the previous tax exemption regime was being applied had become overly-generous and that abuses had crept into the system. Therefore, in 2000, the *Municipal Tax Act* was amended to clearly establish new criteria which had to be met in order for certain categories of property owners, not otherwise expressly exempt, to apply for municipal tax exempt status. The players involved, the Municipal Commission charged with adjudicating the exemption applications, as well as the municipal assessors and the tax authorities were all well aware of the need and thinking behind the reform.

In Quebec, save and except for a few exceptions, land and buildings are assessed at their actual value in the hands of owners and entered on the real estate assessment role. Once the values of land and buildings are entered on the municipal assessment roll, in the absence of exemption, they are taxable.

For the most part, exemptions from municipal taxation are driven by the nature of the entity in whose name the assessment is entered in the real estate assessment roll. For example, units of assessment entered in the name of the province, government agencies, local municipalities and certain religious institutions (subject to a number of conditions), are specifically listed in the *Municipal Tax Act* as being exempt. In some cases, not only must the assessment be entered in the name of a specified entity, but certain activities consistent with the aims and objectives of that entity must be carried on the property in order for the exemption to apply.

Subsection 204(10) of the *Municipal Tax Ac*t sets out the provisions under which certain properties may enjoy exempt status if they are able to obtain a ruling to that effect from the Municipal Commission. It is the conditions and criteria governing those rulings that were subject to the reform referenced above.

In 2000, at the time of the reform, all entities in whose names assessments were entered on the real estate assessment roll across Quebec and which had already obtained a judgment or ruling from the Municipal Commission to the effect that they were exempt from property taxes had to re-apply under the new regime. Specific transitional rules were set out establishing time lines and requirements for entities to re-appear before the Municipal Commission and attempt to re-establish their exempt status pursuant to the new criteria. A significant number of formerly exempt units of assessment became, in whole or in part, taxable as a result of this process. Undoubtedly, this was an objective of the reform.

The *Municipal Tax Act* sets out the procedure and criteria governing applications for exempt status. Firstly, a number of basic initial conditions regarding the person in whose name the unit of assessment is entered on the real estate assessment roll (such as being a not-for-profit legal entity) must be met. Once the initial conditions are met, the substantive criteria for obtaining the exempt status must be considered as they relate to the use being made of the property. It is critical to clearly establish, amongst other things, who is the owner

of the property, in whose name the property is entered on the real estate assessment roll, who is making the application for the exempt status, what entity is occupying the property and what the basis for the request for exempt status is. Complex legal structures for the holding of real estate can create barriers to obtaining a municipal tax exempt status. Moreover, one must always keep in mind that the legal concepts of real property rights in Quebec are different from the "bundle of rights" theory of the common law jurisdictions and, again, can be the source of some frustration for applicants.

As for the substantive conditions, that being the use being made of the property by the owner and/or occupant, one must ensure that the use in question fits squarely within the parameters of the legislation. The user must carry on, without pecuniary gain, one or more eligible activities in such manner that the carrying on of those activities constitutes the main use of the property.

When the Municipal Commission considers an application, it will want to understand, in addition to ensuring that all the preconditions are met, exactly what use is or will be made of each area within the building and for what period of time during the calendar year (use, area, time). Exempt status will be granted for the specific space used in an eligible fashion and in a predominant manner. In other words, evidence must be provided almost square foot by square foot of the use of the property for each day of a given calendar year. When dealing with larger buildings with a variety of different uses and users, all claiming to fall within the scope of the exemption, an orderly, complete and concise management of the proof is essential. Temporal aspects of the analysis will allow the Municipal Commission to determine whether the use in question is the "main use of the immoveable".

Other issues that arise in the application process stem from whether revenues are generated from the uses in question, and whether those revenues constitute a pecuniary gain. The Act goes on to further define and delineate what revenues might constitute a pecuniary gain. Another challenge that can arise is to determine whether access to the immoveable is "offered to the public without preferential terms". Conditions of membership, of one form or the other, must be considered carefully.

The activities which are eligible for exempt status are as follows:

(1) the creation, exhibition or presentation of a work in a field of artistic endeavour, provided, in the case of an exhibition or presentation, the attendance is offered to the public without preferential terms;

(2) any activity of an informational or educational nature intended for persons who wish to improve their knowledge or skills in any field of art, history, science and sport or any other recreational fields, provided participation in the activities is offered to the public without preferential terms;

(3) any activity carried on to :

  (a) promote or defend the rights or interests of persons who, by reason of their age, language, sex, sexual orientation, race, colour or ethnic or national origin, or because they have a disease or an handicap, form a group;

  (b) fight any form of illegal discrimination;

  (c) assist oppressed persons who are socially or economically disadvantaged or otherwise in difficulty; or

  (d) prevent persons from finding themselves in difficulty.

The Municipal Commission will look to determine whether the specific use of a given property falls within one of the three above mentioned criterion and to see whether other preconditions of the tax exempt status have been met. As mentioned above, many entities that historically enjoyed tax exempt status were surprised to find lawyers representing the tax authorities arguing vigorously before the Municipal Commission that the uses in question, although socially redeeming, did not fit within the above-mentioned criteria and that the tax exempt status was no longer available. The Municipal Commission has applied the new criterion established in the 2000 reform in a strict fashion, requiring parties petitioning for exempt status to make their case in an environment which at times can be challenging if not adversarial.

CRA RELEASES NEW LIST OF QUALIFYING FOREIGN CHARITIES

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The *Income Tax Act* provides that a donor to a charity is only able to obtain the usual individual tax credit or corporate tax deduction if the recipient charity is also a "qualified donee". Similarly, a Canadian registered charity may only make a grant to another charity if it is a qualified donee. While the most common type of qualified donee is a Canadian registered charity, there are others. One particular type of qualified donee is "a charitable organization outside Canada to which Her Majesty in right of Canada has made a gift in the year or in the twelve month period preceding the year".

The Canada Revenue Agency ("**CRA**") maintains information circular IC84-3R5, *Gifts to Certain Charitable Organizations Outside Canada*, which discusses this type of foreign charity. The CRA also publishes on a more or less annual basis an attachment to IC84-3R5 in which it lists the charities that Her Majesty in right of Canada (the Federal Government) has made official gifts to in recent years. While the list is incomplete (for example, it does not include foreign charities that have received Canadian International Development Agency grants (which CRA does not believe are gifts - we disagree)), it is a useful list.

The July 13, 2007 addition of the attachment shows that in 2006 and 2007 the Federal Government made official gifts to the following foreign charities:

- Aga Khan Foundation;
- Aga Khan University Foundation;
- Council for Canadian American Relations, Inc.; and
- Roman Catholic Archbishop of Kingston.

The charities listed have all received such gifts in the past with the exception of the Roman Catholic Archbishop of Kingston. We expect that the Archbishop (essentially the Roman Catholic Church in Kingston, Jamaica) was added in order to allow Jamaican Canadians to flow gifts back to Jamaica to assist in dealing with hurricane recovery.

Miller Thomson's charity tax lawyers are familiar with the different procedures for adding foreign charities to the list.

FEDERAL GOVERNMENT RELEASES DRAFT LEGISLATION TO IMPLEMENT REMAINING MEASURES FROM BUDGET 2007

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Readers will recall our article confirming Budget 2007 extended the exemption from tax on gifts of publicly listed securities to Private Foundations made on or after March 19, 2007. This measure was applauded and continues to be accepted as a positive initiative designed to encourage philanthropy in Canada.

We also confirmed that the Government proposed rules designed to address a concern raised by Department of Finance officials that by virtue of their and the foundation's combined share holdings, persons connected with a foundation could have influence over a corporation that they may use for their own benefit.

The draft legislation released contains the new legislation for both these measures. The draft legislation incorporating the extension of the exemption from tax on capital gains is straightforward and we applaud this initiative. The legislation which implements the excess business holdings regime applicable only to private foundations is a disappointment and raises concerns.

Since March, representations have been made by various organizations, 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. It was hoped that the draft legislation would include changes to address the concerns raised. It did not.

The new rules will apply to all private foundations beginning with their first taxation year that begins on or after March 19, 2007. They apply to holdings of both public and private company shares. They adopt arbitrary limits and in no way try to work with existing regulatory regimes (for example, the *Charitable Gifts Act* (Ontario) which limits business holdings to 10 %.)

The new rules identify three ranges of shareholdings and apply different rules to each range.

Safe Harbour

Where a private foundation holds 2% or less of all outstanding shares of each class of a corporation, the foundation will be in a "safe harbour". If the foundation is in this range, it will not be required to monitor, report or divest itself of any shares.

Monitoring Phase

Where a private foundation, at any time in a taxation year, holds in excess of 2% of the outstanding shares of one or more share classes of a corporation, it will be required to determine and report to the Canada Revenue Agency (CRA), the shares held at the end of the year in all share classes of that corporation, by it and by any person not dealing at arm's length with the foundation.

The foundation will also be required to report any material transactions of the foundation or the non-arm's length person(s) which took place at a time when the shareholdings were in excess of the safe harbour limit during the year. A transaction will be material if it involves the acquisition or disposition of more than $100,000 worth of shares of a particular class or more than 0.5% of the outstanding shares of a particular class.

This reporting will presumably be on the T3010 Information Return and will be available to the general public on the CRA Charities Directorate website except that the names of the non-arm's length persons will only be disclosed to CRA: they will not listed on the website.

Divestment Required

Where the private foundation and all non-arm's length persons together hold more than 20% percent of all outstanding shares of any share class of a corporation, the rules will require the foundation or the non-arm's length persons (or a combination of the two) to divest themselves of the shares so the combined holdings are 20% or less. Penalties will apply to the foundation where the foundation and the non-arm's length persons have not reduced their combined shareholdings of that class to 20 percent within specified time periods.

The same reporting requirements and thus public disclosure apply to the foundation at this stage as well.

Non-arm's length

Non-arm's length persons for these purposes will include any person, or member of a related group of persons, that controls the foundation, and any person not dealing at arm's length with such a controlling person or controlling group members. Special rules will apply to deem persons not to be related to a controlling person or member of a control group. These rules will require an application to the Minister for a determination that the person is dealing at arm's length and will be available where a person is 18 years of age and living separate and apart from the controlling person or member of the control group. It will be a fact based determination and we expect the onus will be on the individual or the foundation to prove the arm's length status.

Timing for Divestiture

Where a divestiture is required, the length of time in which the foundation or the non-arm's length person must divest will depend on how the excess business holdings arose. For example, if the foundation had purchased the shares, the divestiture must be completed by the end of the year while if the excess is the result of a bequest, the excess must be divested by the end of the 5th subsequent year. The theme is if the shares were purchased by the foundation or a non-arm's length person, the divestiture must be completed sooner than if the excess is the result of a gift. CRA will also have discretion to specify conditions and defer divestiture upon application.

Penalties

The Budget proposals announced that the penalty for failing to comply with the divestiture requirements would be an intermediate sanction assessed against the private foundation. The initial penalty will equal 5% of the value of the excess holdings at the end of the relevant period. If there is a second offence within 5 years, the penalty will be 10%. The draft legislation also provides that failure to comply can be grounds for revocation of registered status.

Further, where the foundation has been found to have an excess holding and the foundation has failed to provide the required information relevant to excess holdings, the excess business holdings penalty will be doubled.

Transitional Rules

These proposals contain substantive transition provisions which will allow foundations to divest, over a period of 5 to 20 years excess business holdings present on March 18, 2007. Unfortunately these rules are not as generous as they should be for private foundations that structured their affairs prior to the announcement of this regime. Such private foundations and the families which establish and control them properly structured their affairs in ways which were permitted under the applicable provincial and federal regulation. Forcing such foundations and related persons to restructure may have serious consequences for family controlled businesses. It is simply not appropriate to force existing charities to restructure affairs, particularly where there is no hard evidence of the concerns raised by Finance officials about abuses in the public domain. We do not expect that such abuses are widespread and submit that the current regulatory regime is sufficient to address these concerns.

As drafted the transition rules apply to existing private foundations that are offside the new rules. Subject to detail, the transitional rules generally require that the excess holdings be reduced by 20% every 5 years until they are eliminated. Finance officials have indicated previously that in discussions with the IRS about these rules, this timeline was considered to be sufficient. We disagree. What they fail to acknowledge and address is that where the shares in issue are private company shares, there may be no market for the shares - even in 5 years and if they are public shares - the sale of such an amount can significantly impact the control of a public company in the market.

A further unfortunate aspect of these rules is that the government proposes to deny to donors to Foundations that are not able to eliminate the excess business holdings before March 18, 2012, the exemption from tax on the capital gain realized on gifts of publicly listed securities. To give with one hand and take away with the other seems unreasonable. It is not obvious why if the transition rules are appropriate, the government felt the need to add this penalty to those that need to take additional time. Hopefully this aspect of the proposals will be eliminated as we move forward.

Conclusion

It is extremely unfortunate that the government has chosen to introduce these new rules without adequate consultation and review. They introduce a new layer of complexity for private foundations whether they receive gifts of publicly listed securities (which benefit the donors) or not. It is anticipated that philanthropic wealthy Canadians, those owning businesses and who play an important role in their communities, will be put off by these restrictive rules. They further ensure that otherwise legitimate structures adopted by charities and acceptable to the Canada Revenue Agency in the past will become unavailable.

We believe that Finance officials have not had a full opportunity to consider 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.

WHAT'S HAPPENING AROUND MILLER THOMSON LLP

The September issue of *Canadian Not-for-Profit News* contained "Gifts to Her Majesty", "Investing Out of Canada", "Helping Ethical Investors", "Fundraising Turf Wars in Kingston", "Russia Tightens Screws on NGOs", "Scientology Gets a Big Win", "Common Sense Break for Organ Donors" and "Religious Schools Early Issue in Ontario Election" by **Arthur Drache**.

The September Issue of *Canadian Fundraiser* contained an article titled "There are times when not doing a gift is the better choice" describing **Robert Hayhoe's** presentation at the Annual Conference of the Canadian Council of Christian Charities.

Robert Hayhoe presented on "Canadian Tax Rules" at the IFMA/EMS Annual Meeting in Minneapolis on September 29.

On October 2, **Sandra Enticknap** presented on "Managing Risk - Protecting Special Purpose Assets", **Robert Hayhoe** presented on "Charity Audits and Intermediate Penalties". **Paul Devine** presented on "Current Employment Issues", **Stephen Burri** presented on "Managing Intellectual Property", **David Rice** presented on "Current Employment Issues". and **Kenneth Burnett** presented on "Current Corporate Governance Issues" as part of Not-For-Profit Organizations in British Columbia organised by Lorman Education Services.

On October 16, **Kate Lazier** and **Robert Hayhoe** presented on "CRA Charity Audits and Penalties" as part of Not-For-Profit Organizations in Ontario organised by Lorman Education Services.

On October 18, 2007, **Hugh Kelly** presented "By-laws: The What, The Why and The How" at a seminar jointly sponsored by Volunteer Lawyers Service, United Way of Great Toronto, and the City of Toronto Community Resources Unit.

Robert Hayhoe was quoted in "New Rules for Gifts to Private Foundations" by Bev Cline in the October 22, 2007, *Law Times* newspaper.

Kristina Shaw gave a presentation on "Selected Topics in Charities Law" to the London and Region Fund Raising Executives.

The Fall 2007 Newsletter *Patrimoine* published by the University of Montreal, contained an article by **Richard Fontaine** titled "Un don planifié: le fruit d'une decision éclairée.

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