September 13, 2005

Massimo Pacetti, M.P.
Chair
Standing Committee on Finance
Room 673
Wellington Building
House of Commons
Ottawa ON K1A 0A6

Dear Mr. Pacetti:

The Canadian Bar Association is pleased to participate in the pre-budget consultations. The Canadian Bar Association is a national association representing 34,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

We have identified a number of priority issues that we trust the government will consider in its upcoming budget.

Legal Aid

The Canadian Bar Association urges the federal government to improve access to justice through better funding for legal aid and by ensuring adequacy and consistency of legal aid services across the country.

Many people have no access to the protections the law promises to them, no access to justice at all. The people hurt by not being able to enforce their legal rights and protections are those already most disadvantaged in Canadian society. The cost of inadequate legal aid is great. For example, failing to pursue legitimate claims for support increases child poverty, and increases demands on social assistance programs.

While delivery of legal aid is primarily a provincial or territorial responsibility, the federal government can show leadership:

- by increasing funding for civil and criminal legal aid
- by tying its spending to what is actually spent by the province or territory
- by setting minimum national standards for access to justice that are guaranteed for everyone.

500 - 865 Carling, Ottawa, Ontario Canada K1S 5S8
Tel/Tél. : (613) 237-2925 Toll free/Sans frais : 1-800-267-8860 Fax/Télécop. : (613) 237-0185
Home Page/Page d'accueil : www.cba.org E-Mail/Courriel : info@cba.org

Parental Benefits for Self-Employed Workers

The Canadian Bar Association urges the federal government to extend maternity and parental benefits to self-employed workers. While the constitutionality of special benefits under the *Employment Insurance Act* is at issue before the Supreme Court of Canada, the federal government nonetheless signed an agreement in March 2005 with the Quebec government, to implement that province's parental insurance plan. The Quebec plan serves as one possible model to extend these benefits to all self-employed workers in Canada.

Creditor-proofing RRSPs

Retirement income schemes should provide internal fairness for Canadians who rely more heavily on RRSPs for their retirement income — self-employed professionals and Canadians in small-and medium-sized businesses. The Canadian Bar Association believes that creditor-protecting RRSPs will assist in encouraging individuals to save for their retirement. This, in turn, particularly with an aging population, reduces the reliance on government. The Canadian Bar Association was pleased to see this introduced in Bill C-55, the *Wage Earner Protection Program Act*. We will comment on the proposal in greater detail in a comprehensive analysis of that bill.

Voluntary and Not-for-Profit Sector

The CBA's Charities and Not for Profit Law Section notes an unfortunate tendency towards significantly increased complexity in the regulation of registered charities under the *Income Tax Act* and the attendant problems this creates. Charities encounter increasing difficulty in attracting capable volunteers to serve on their boards of directors or otherwise assist them in their endeavours. Specific problems are outlined in the attached documentation.

We urge the federal government to undertake a fundamental review of the underlying policies that should govern the approach to the regulation of registered charities from a tax perspective. We also recommend that the government take steps to ensure that unnecessary complexity, inconsistencies and red tape are eliminated.

Rollover of RRSPs or RRIFs to a spousal trust

The CBA's Wills, Estates and Trusts Section proposes an amendment to the *Income Tax Act* to permit the rollover of a Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF) to a trust for a spouse or common-law partner. This is similar to the proposal for a rollover of an RRSP/RRIF to a trust for a handicapped child in the spring 2005 budget. This proposal is tax neutral. The attached October 2004 letter to Finance Canada outlines the proposal in greater detail.

The Canadian Bar Association appreciates the opportunity to put forward these proposals in the pre-budget process. We look forward to discussing these matters with the Finance Committee in greater detail.

Yours truly,

(*Original signed by Brian Tabor*)

Brian A Tabor, Q.C.

BUDGET ISSUES FOR THE VOLUNTARY AND NOT-FOR-PROFIT SECTOR

OVERVIEW

The Charities and Not-for-Profit Law Section of the CBA is pleased to participate in the pre-budget consultation process. The voluntary and non-profit sector in Canada is a significant contributor to the social fabric and financial stability of the nation's economy. We do not propose to deal with facts and figures, and leave those aspects to other groups with more detailed information in that regard. Our remarks are aimed primarily at broad policy issues and technical legal issues we see as lawyers throughout Canada who advise charities and not-for-profit organizations, and in many cases participate as volunteers for those organizations. Our remarks focus on the unfortunate tendency towards significantly increased complexity in the regulation of registered charities under the *Income Tax Act* and the attendant problems this creates, not only for legal advisors, but for the charities themselves, who encounter increasing difficulty attracting capable volunteers to serve on their boards of directors or otherwise assist them in their endeavours.

While by its very nature tax law is complex, we believe that much of the complexity is unnecessary. It is time for a fundamental review of some of the underlying principles that have led to the complexity. By way of example, the recently enacted changes in Bill C-33 dealing with the disbursement quota, transfers of funds between charities and similar issues have demonstrated beyond any doubt that the regulatory tax tail is wagging the charity sector dog.

We realize that the present consultations are intended to focus on pre-budget issues. However, we wanted to take the opportunity to bring to your attention our concerns about a number of technical issues under the existing law, including Bill C-33 and the July 2005 draft legislation.

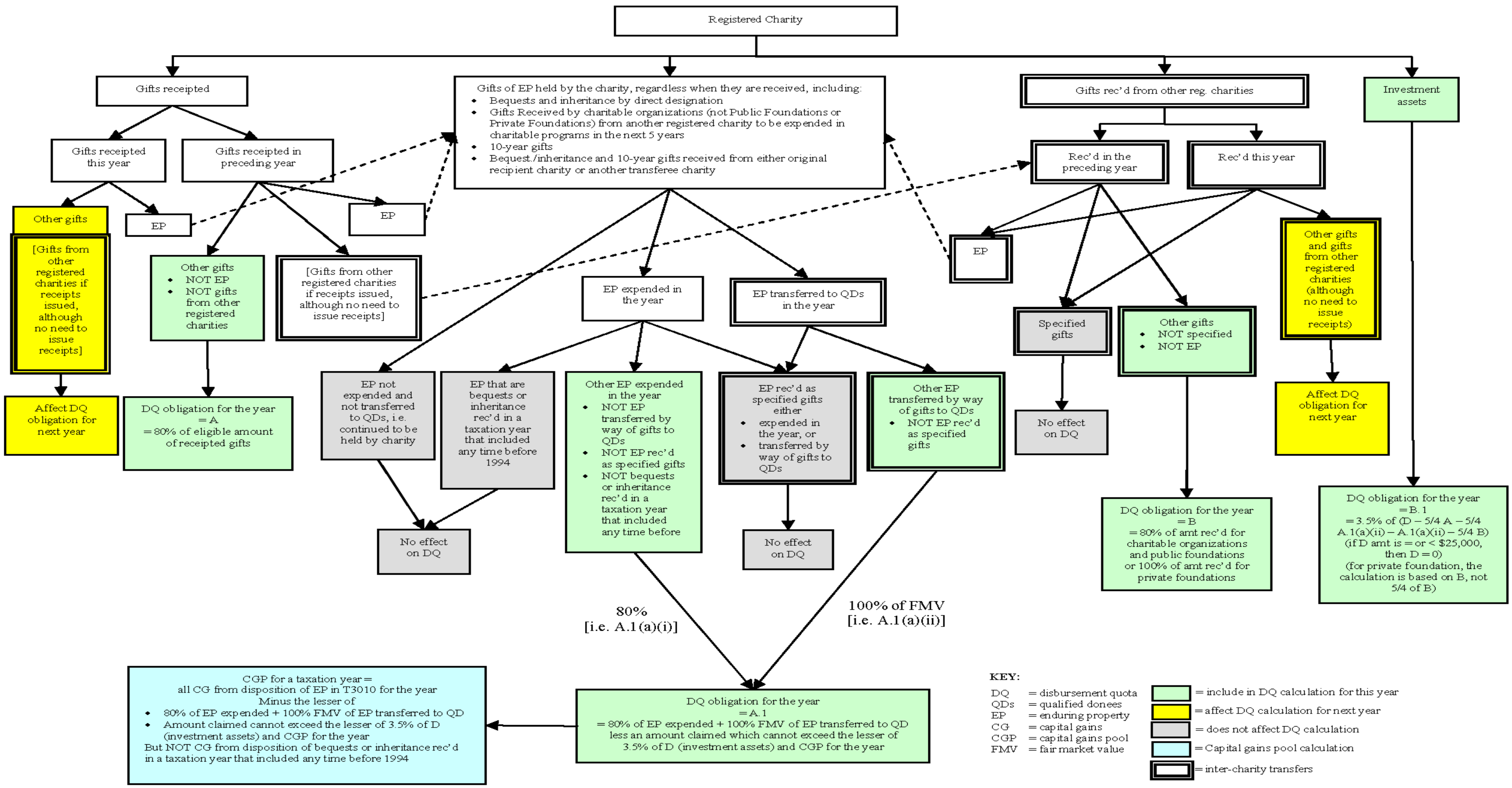
Our comments address incentives to encourage charitable giving while at the same time recognizing the ongoing need for vigilance and regulation, to ensure that funds raised with tax-incentives are properly administered and expended.

We recommend that the government set aside resources and direct the Department of Finance to take steps to ensure unnecessary complexity, inconsistencies and red tape are eliminated and a fundamental review is undertaken with respect to the basic policy issues that should govern the approach to the regulation of registered charities from a tax perspective. While the proliferation of registered charities clearly presents administrative problems for the Canada Revenue Agency, both in reviewing applications for registration and in auditing registered charities, we believe there should not be an underlying assumption that all registered charities or donors are likely to engage in questionable or improper conduct.

The objective of increasing productivity in the voluntary sector is at odds with increased complexity. The devotion of resources by registered charities to increasingly complex compliance matters, particularly the disbursement quota, effectively robs the sector of an opportunity to spend both financial resources and human resources on their true objectives. This can be illustrated by the chart on the following page, prepared by two section members for a recent technical paper, which shows the complexity of the new rules.

The CICA/CBA Joint Taxation Committee has made an extensive list of technical points in response to the July 18, 2005 draft legislation. Without commenting specifically on those comments, we merely point out our concern that those in registered charities responsible for compliance will not be able to understand these issues.

Calculation of Disbursement Quota under Bill C-33



ISSUES

1. INCENTIVES FOR GIFTS OF MARKETABLE SECURITIES

The Section reiterates its support for the tax incentive for gifts of marketable securities. We recommend that it be extended to eliminate altogether the capital gain on such gifts and be extended to gifts to private foundations and gifts of real estate. We remain concerned that there appears to be a tendency to attack the efficacy of the current incentives.[1] We believe that the extension of the incentive to private foundations is desirable, subject to appropriate safeguards against abuse and failure to monetize such gifts. We also believe that the incentive should be extended to gifts of real property and eliminate altogether the capital gain on such gifts.

2. CHARITABLE REMAINDER TRUSTS

We understand there are ongoing discussions about new rules that would encourage the establishment of charitable remainder trusts. We support those discussions and recommend that the government pursue them vigorously.

3. TECHNICAL ISSUES

The July 18, 2005 draft legislation contains a number of highly technical proposed amendments.

(a) Control

The rules for the designation of registered charities are a concern. The tests to ensure that a registered charity will not be designated as a private foundation include determining whether a person or group is in a position to "control" the charity. The new rules use the control test applicable to business corporations, where there is influence rather than control through the election of the board of directors. We believe this test is inappropriate. Many public registered charities will be adversely affected if they are designated as private foundations. If they are not able to determine with some certainty whether donors will be regarded as having "control" over them, they may be required to turn away potential gifts or discourage significant donors from participating in their affairs, such as by joining their boards of directors.

We recommend that the control test be applied without regard to the extended definition, and that a rule be adopted that recognizes control in most circumstances as the ability to elect the board of directors. We believe this would be an adequate safeguard against abuse while providing more certainty for registered charities and donors.

Furthermore, the proposed changes in the definitions of public foundation and charitable organization in subsections 149.1(1) as set out in subsections 148(1) and (3) of the draft legislation are ambiguous as they relate to the "double barrelled" test for contributions. In proposed new definition of public foundation and charitable organization, the test for contributions is to be made at two points in time and seems to assume there has been a "last contribution" at or before the particular time. However, it is not clear how this works or what it means. We therefore suggest that the drafting should be clarified.

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[1] We wrote in March 2004 to this Committee expressing our concerns about two academic articles in the Canadian Tax Journal.

(b) Split-Receipting

The July 18, 2005 draft legislation will enact changes first announced in December 2002 and further changes announced in December 2003, including changes dealing with so-called “split-receipting”. We applaud the thrust of the changes, and encourage the government to continue to ensure that tax incentives for donors are not subject to abuse. However, the new rules raise serious questions from a policy perspective and an implementation perspective.

(c) Holding Periods

The rule that a donor must use the cost rather than the fair market value of property as the value when making a gift if the property was acquired in the preceding three years will be extremely unfair in many situations. So will the rule under which a donor must use the cost rather than the fair market value of property if it was acquired in the preceding ten years, if one of the main purposes at the time of acquisition was to make a gift. We recognize that the Canada Revenue Agency faces serious challenges in administering the tax rules, in the face of aggressive tax shelter promotions and factual issues, particularly those that must ultimately be decided in court, such as the fair market value of property. However, we are concerned that the proposed solution is overreaching and will cause many legitimate gifts to be abandoned and create unnecessary disincentives for donors.

For instance, the rules do not recognize that property can be moved within a related group of taxpayers for legitimate reasons within a three- or ten-year period. As now worded, the rules will penalize a group of related or non-arm’s length taxpayers if there is a transfer of property, even if that transfer occurs at fair market value, by denying any subsequent increase in value to the taxpayer who makes a gift. We recommend that relief be granted in appropriate cases to recognize that a new holding period would not begin with a change of ownership.

The rules recognize the need for flexibility. In limited circumstances they will permit a taxpayer to transfer property to a corporation and then give the shares of the corporation to a qualified donee, or permit the corporation to give the property to a qualified donee. However the relief does not extend to situations involving partnerships. We believe this discrimination is inappropriate and we recommend similar relief, subject to suitable safeguards, in situations involving partnerships.

(d) Due Diligence

Where the donor receives some advantage, the eligible amount of the gift is reduced. We agree that this is appropriate. However, the rules also impose significant compliance burdens on qualified donees, requiring them to cross-examine donors to find out if they are engaging in inappropriate behaviour. We do not condone inappropriate behaviour, but we submit that qualified donees, in the absence of actual knowledge, should not be assumed to have issued official receipts in excess of the appropriate amount. The rules require qualified donees receiving gifts in excess of $5,000 to make reasonable enquiries or face potential penalties for issuing official receipts for excessive amounts. We agree there are abusive situations, but we are concerned that the response is excessive. We recommend that regulations be passed to define “reasonable inquiry”, consistent with the technical notes previously issued by the Department of Finance. Otherwise, we believe qualified donees will face potentially huge administrative costs and be required to devote their hard-earned resources to unnecessary compliance.

We recognize that this will require a balance between the legitimate need to safeguard the use of public funds, on the one hand, and the ability of qualified donees to carry out their activities effectively, without becoming part of the tax administration.

(e) Penalties

Qualified donees will be subject to penalties if they issue official receipts for excessive amounts. The rules should be changed to ensure that qualified donees who make reasonable inquiries are not exposed to these penalties if the donor is not entitled to use the fair market value of the property in determining the eligible amount of the gift. While this may seem like a technical point, it is of major significance for qualified donees, who might otherwise be exposed inadvertently to penalties, despite complying with the rules.

4. NOT-FOR-PROFIT ORGANIZATIONS

Under paragraph 149(1)(l) of the *Income Tax Act*, a club, society or association will be exempt from tax if it meets certain criteria. However, one of the prerequisites is that the Minister of National Revenue must not be of the opinion that the organization is a “charity”. This limitation is designed to ensure that charities otherwise able to seek registration and become exempt cannot avoid the compliance required of such registered charities by choosing the alternative exemption under paragraph 149(1)(l). In order to be registered, an organization must be resident in Canada. Many foreign organizations operate in Canada and will be subject to tax if they cannot rely on the exemption in paragraph 149(1)(l), since they are not eligible to be registered as charities. The limitation should be narrowed, to ensure that the Minister is able to express an opinion only where the organization in question would otherwise be entitled to become registered, if it met the criteria for registration. In particular, non-resident organizations that cannot qualify for registration should not be precluded from exemption under paragraph 149(l)(l) merely because they are “charities”.

RECOMMENDATIONS

We recommend that:

1. **the incentive for gifts of marketable securities extended to gifts to private foundations and gifts of real estate, and the capital gain on such gifts be eliminated;**
2. **the Department of Finance be allocated sufficient resources to undertake a comprehensive review of the underlying policies that have resulted in the increasing complexity of the tax rules relating to registered charities, particularly those dealing with the disbursement quota, and a consultation process with the charities sector be begun to simplify this regime;**
3. **the concept of control be changed to eliminate the reference to indirect control through influence;**
4. **appropriate rules be added to recognize holding periods within related groups, without requiring each new owner to start the three year period or ten year period running again;**
5. **the proposals relieve a qualified donee from penalties for issuing an official receipt in excess of the eligible amount, if reasonable enquiry has been made as to the circumstances of the gift, regardless of the information received from the donor;**

6. **paragraph 149(1)(l) be amended to provide that the opinion of the Minister that a club, society or association is not a charity is required only where the charity is a resident of Canada;**

7. **the charitable remainder trust initiative be pursued vigorously.**

THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN
The Voice of the Legal Profession
La voix de la profession juridique

October 19, 2004

Mr. Len Farber
General Director
Tax Legislation Division, Tax Policy Branch
Department of Finance Canada
140 O'Connor Street
Ottawa ON K1A 0G5

Dear Mr. Farber:

Re: Rollover of RRSP's and RRIF's to a Trust for Spouses and Disabled Financially Dependent Children

I am writing on behalf of the National Wills, Estates and Trusts Section of the Canadian Bar Association (CBA Section), to support an amendment to the Income Tax Act pertaining to the rollover of a Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF).

The CBA is a national association representing over 38,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

The CBA Section proposes the following amendments to the *Income Tax Act*:

- The rollover of an RRSP or RRIF to a trust for a spouse (including a common-law partner).
- The rollover of an RRSP or RRIF to a trust for a financially dependent child or grandchild.

The first issue was presented at a meeting in October 2002 with Department of Justice officials. The second issue arises out of the December 2002 technical amendments to section 60(l) of the *Income Tax Act*.

A. ROLLOVER OF AN RRSP OR RRIF TO SPOUSES

Background

As estate lawyers, members of the CBA Section encounter difficult estate planning issues with second marriages and second common-law relationships, especially where there are children from the first relationship. Testators will usually be motivated to ensure that their second spouse or partner has adequate income but want the capital of their estate to be transferred to their children from the first marriage upon the death of both spouses. The spousal trust is an excellent tool in these circumstances. It allows the estate to be invested for the benefit of the surviving spouse for life, with all the income paid to the spouse for life and the power to encroach on capital if the income is insufficient. Upon the death of the second spouse, there is a deemed disposition of the assets with the tax payable by the estate of the first spouse to die.

The difficulty is that an RRSP or RRIF cannot be rolled over to a spousal trust. With significant amounts being accumulated in RRSP's and RRIF's in many estates, this is a substantial roadblock to estate planning.

Proposal

The CBA Section proposes the following:

i. An individual could designate a trustee to hold an RRSP or a RRIF on trust for a surviving spouse or partner for the life of the spouse or partner. The trustee would have control over withdrawals from the RRSP and when the surviving spouse or partner reaches age 69 would be required to convert the RRSP to a RRIF.

ii. The amendment would allow the RRSP or RRIF to continue in the same form, rather than requiring the trust to purchase an annuity (as is the case for dependent children under s. 60(l)). This would give the trustee the discretion concerning investments in the trust and to decide if and when an encroachment would be made by a withdrawal from the RRSP. This is the same tax effect as if the RRSP or RRIF were rolled over absolutely to the spouse or partner.

iii. Any withdrawal from an RRSP or RRIF could be required to be paid to the surviving spouse or partner and therefore be taxed in his or her hands. In the alternative, it would be useful to enable such funds to continue to be held in the trust with the trustee retaining discretion to use the funds for the benefit of the surviving spouse or partner. From a tax perspective, there might be a requirement that any withdrawal from the RRSP or RRIF be taxed in the hands of the surviving spouse or partner and perhaps even a requirement that withdrawals be vested absolutely in the name of the surviving spouse. The result would be that such withdrawals would form part of the estate of the surviving spouse on his or her death. The balance of the capital remaining in the trust on the death of the spouse could then be divided among the alternate beneficiaries (for example, the children from the first marriage).

iv. On the death of the surviving spouse, the RRSP/RRIF would be taxed in the hands of the first spouse (the testator) in the T3 return of the testator in the year of the death of the second spouse. The tax would be paid at the graduated rates of the testamentary trust, in that year.

Revenue Neutral

The result of this proposal is revenue neutral:

- With the current rules, withdrawals from an RRSP or payments from a RRIF are taxed in the hands of the surviving spouse who owns the RRSP or RRIF. With our proposal, withdrawals from an RRSP or payments from a RRIF are taxed in the hands of the surviving spouse, but the RRSP or RRIF will be owned by the trust.
- With the current rules, the RRSP or RRIF will be taxed as income in the hands of the surviving spouse on the death of that spouse (unless there is a further rollover to a dependent child). With our proposal, the RRSP or RRIF will be taxed as income in the estate of the first spouse to die, in a manner similar to the taxation of the assets in a spousal trust on the death of the second spouse (unless there is a further rollover to a dependent child). In some circumstances, this could result in more tax than if taxed in the hands of the second spouse to die.

B. DISABLED CHILDREN AND GRANDCHILDREN

i. December 2002 Technical Amendments to Section 60(l)

Technical amendments to the *Income Tax Act* were introduced in December 2002 to allow for an RRSP or RRIF to be rolled into a trust for a dependent disabled child by the purchase of an annuity by the trust for the child. These changes were welcome. We submit, however, that the changes do not allow enough flexibility in estate planning for disabled children.

ii. Use of a Trust for RRSP's and RRIF's for Dependent Disabled Children

The rollover available to a child or grandchild who is financially dependent on a deceased taxpayer by reason of physical or mental disability is essentially the same as the rollover available to a spouse. The disabled child may rollover the refund of premiums to an RRSP or RRIF or an annuity. Prior to the technical amendments, it was our understanding that the funds must vest absolutely in the name of child in order to achieve this rollover.

The difficulty with absolute vesting is that if the disabled child is mentally disabled, that child will not likely be capable of managing RRSP investments or deciding when it is prudent from a tax perspective to make a withdrawal from the RRSP. It is therefore appropriate for the parents to establish a trust in their wills whereby all of the money will be held on trust for the child with power for the trustee to encroach upon income or capital when appropriate.

Most parents with disabled children would want to control the eventual disposition of the RRSP upon the death of the disabled child. A trust for the disabled child allows this. Upon the death of the child, the trust can provide a gift over to the other children or other beneficiaries.

We propose that the *Income Tax Act* permit the rollover of the parent's RRSP or RRIF to an RRSP or RRIF or annuity held in a trust for a disabled child.

iii. Government Benefits for Disabled Adults and Use of Discretionary Trust for Disabled Children

Most provinces provide a benefit payable to disabled persons to provide for their day-to-day living needs. If that individual receives income or capital, including interest or employment income, that exceeds a certain amount per month, the benefit will be reduced. It is therefore important to provide for the child in a manner that will not reduce this government benefit. Increased flexibility in the planning for a disabled child will allow a safety net for the needs of such a child, should such needs change in the future or should government funding change.

It is prudent for the parents of a disabled child to establish a discretionary trust in their wills for the child. The discretionary aspect of the trust is important for two reasons:

- The child is not capable of managing the inheritance and needs a trustee to manage the funds.
- In most provinces, this kind of a trust should allow the government benefit to continue to be paid to the child. This allows the trustees to maximize other available funding for the child. The trust therefore operates as a safety net in the event that government funding programs are later changed or if the child requires something extra beyond what is paid by the benefit program.

iv. Impact of Technical Amendments

Prior to the technical amendments, no provision in the *Income Tax Act* allowed the RRSP to be held in a discretionary trust described above. The amendments partially solve this problem, but restrict the solution to the purchase of an annuity in the trust for the dependent child. The difficulty is that the annuity pays income to the trust, which is taxed in the trust, if the income is retained in the trust. This may not always be appropriate. If the income is paid to the child, the child will pay the tax at his or her graduated rates. The problem is that the child's government benefits will probably be reduced. If the income is retained in the testamentary trust, the trust pays the tax without the benefits of the basic personal exemption. As a result, more tax is paid than if the RRSP were rolled to the child's RRSP. We propose that the *Income Tax Act* also allow for the rollover of an RRSP or RRIF to an RRSP or RRIF held in a trust for a disabled child, as well as an annuity.

We suggest that the *Income Tax Act* be amended in a manner similar to that suggested for spouses to allow a parent's RRSP or RRIF to be rolled over to an RRSP, RRIF or annuity held in a trust for a disabled child. Our proposal would work exactly the same as the proposal for a trust for a spouse.

The CBA Section's comments concerning revenue neutrality on spousal trusts apply equally to a trust for a disabled child. The funds would be taxed in the estate of the testator parent on the death of the child.

C. SUMMARY OF PROPOSED TECHNICAL AMENDMENTS TO THE *INCOME TAX ACT*

The following is a partial list of technical amendments to the *Income Tax Act* that may be required to give effect to our recommendations concerning a rollover to a trust for a spouse or for a financially dependent child or grandchild.

i. **Amend section 60(l) by adding after (i):**
As a premium under a registered retirement savings plan under which a trust for the taxpayer is the annuitant, whereby the taxpayer is the sole person beneficially interested in amounts withdrawn from the registered retirement savings plan during the taxpayer's lifetime.

ii. **Amend section 146(1) definition of "annuitant" by adding:**
A trust for the individual's spouse or common-law partner.

iii. **Amend section 146(1) definition of "refund of premiums" to include:**
a. any amount paid to the trust for a spouse or common law partner of the annuitant.
b. any amount paid to a trust for a child or grandchild of the annuitant, who was at the time of death, financially dependent by reason of disability on the annuitant for support.

iv. **Amend section 146(8.91) joint election:**
Where the trustee of the trust for a spouse or common law partner file with the minister a joint election in prescribed form.

v. **Add a new subsection to section 146 after (8.8):**
When the spouse or common law partner dies, the trust for the spouse or common law partner shall be deemed to have received, immediately before the death of the spouse or common law partner, an amount as a benefit out of or under a registered retirement savings plan. (i.e. the trust is taxed on the benefit unless there is a financially dependent disabled child, in which case section 146(8.1) joint election may be made with the child)

Any benefit received from a registered retirement savings plan in a trust for the spouse or common law partner of the individual is taxable in the hands of the spouse or common law partner, and the spouse or common law partner must be entitled to receive all of the withdrawals from the registered retirement savings plan before the death of the spouse’s or common law partner’s death and, no person except the spouse or common law partner may, before the spouse’s or common law partner’s death, receive or otherwise obtain the use of any of the income or capital of the trust (in other words, copy the wording in section70(6)).

vi. **Add a subsection after section 146(8):**
Where a trust is the holder of a registered retirement savings plan for the spouse or common law partner, there shall be included in computing the income of a spouse or common law partner for a taxation year, the total of all amounts received by the trust in the year as benefits out of or under the registered retirement savings plans.

vii. **Amend section 60(l)(iii) concerning registered retirement income funds in the same manner. In other words, allow registered retirement income funds to be held on trust for the benefit of the spouse or common law partner.**

We would be pleased to discuss these proposals with you in more detail. Please telephone me at your convenience at (780) 441 4334.

Yours truly,

(Original signed by Trevor M. Rajah on behalf of Philip J. Renaud, Q.C.)

Philip J. Renaud, Q.C.
Chair
National Wills, Estates and Trusts Section

CC Catherine Cloutier
Chief, Deferred Income Plans
Finance Canada
Tax Legislation Division
Tax Policy Branch