THE CANADIAN BAR ASSOCIATION
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September 15, 2006

Brian Pallister, M.P.
Chair
Standing Committee on Finance
Room 673
Wellington Building
Ottawa, ON K1A 0A6

Dear Mr. Pallister:

The Charities and Not-For-Profit Law Section of the Canadian Bar Association ("CBA Section") is pleased to participate in the pre-budget consultations. The Canadian Bar Association is a national association representing 36,000 jurists, including lawyers, notaries, law teachers and students across Canada. The primary objectives of the CBA include improvements in the law and the administration of justice.

We have identified several issues that we hope the government will consider in preparing its next budget.

OVERVIEW

The CBA Section has for some time taken an active role in income tax policy and administration. The voluntary and non-profit sector in Canada is a significant contributor to the social fabric and financial stability of the national economy. Our submissions are aimed primarily at broad policy issues and technical legal issues which confront our members as lawyers across Canada. Those members advise charities and not-for-profit organizations and in many cases participate as volunteers for those organizations.

As we pointed out in our submission on September 13, 2005 to the Committee, we are very concerned about the unfortunate tendency towards significantly increased complexity in the regulation of registered charities under the *Income Tax Act* and the attendant problems that arise from this trend. This concern arises for both legal advisers and the organizations themselves, which encounter increasing difficulty attracting capable and willing volunteers to serve on their boards of directors or otherwise assist in their activities.

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Tax law is complex by its very nature. However, we believe that much of the complexity in the legislation dealing with the expenditure of funds by registered charities is unnecessary. Last year we called for a fundamental review of some of the underlying principles that have led to that complexity, with particular reference to the disbursement quota, transfers of funds between charities and other issues that continue to demonstrate beyond any doubt that the regulatory scheme has become far too unwieldy. We reiterate that call and enclose a copy of a chart prepared last year by two CBA Section members for a technical paper, which shows this complexity.

We understand that your current consultations are intended to focus on pre-budget issues, with an emphasis on improving competitiveness. Nevertheless, we want to bring to your attention once again our serious concerns about a number of technical issues as well as matters of tax policy which we hope will be recognized in the preparations for the next budget. We believe competitiveness is adversely affected, as is productivity, when scarce or stretched resources are used by charities for compliance and red tape, and not for their core goals.

We address tax incentives that we think will encourage charitable giving while at the same time recognizing the need for vigilance and regulation, to ensure that funds raised with tax incentives are properly administered and expended.

Last year, we recommended that the government set aside financial resources and direct the Department of Finance to take appropriate steps to ensure that unnecessary complexity, inconsistencies and red tape are eliminated or avoided and to undertake a fundamental review of basic policy issues that should govern the whole approach to the regulation and administration of registered charities from a tax perspective. We reiterate that recommendation.

Some of our comments refer to the legislative proposal introduced by the former Minister of Finance on July 18, 2005. While we believe certain elements of the proposal require review and revision, it contains many progressive elements that we are concerned are being allowed to languish unimplemented.

ISSUES

1. Incentives for Gifts of Marketable Securities

We applaud the proposal in the May 2006 budget to eliminate recognition of all gains on gifts of marketable securities to public foundations and charitable organizations. This is a welcome change and we think it will be a catalyst for additional financial support for the charitable sector.

However, we continue to believe that the same incentive should be available for gifts of marketable securities to private foundations and for gifts of real estate to all registered charities. As we have pointed out previously, we believe that appropriate safeguards can be implemented for gifts of marketable securities to private foundations to prevent abuses. These could include, for instance, a requirement that gifts of marketable securities be monetized within a fixed period of time and identical securities not be owned by the charity in a defined period through a related series of transactions. In addition, or as an alternative, there could be a rule that securities forming a part of a significant position (say 10% or more) held by a donor in a particular listed entity would not be eligible for this incentive. The many situations that do not raise concerns about abuse or unintended consequences should be the basis for a general rule, with limited exceptions to deal with potential abuse.

2. Charitable Remainder Trusts

We continue to support initiatives to provide a new legislative framework for the establishment of charitable remainder trusts. We recommend that the government pursue these proposals vigorously.

3. Not-for-Profit Organizations

Under paragraph 149(1) 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 registered charities to maintain their tax-exempt status. To be registered, an organization must be resident in Canada. Many foreign non-profit organizations operate in Canada and will be subject to tax if they cannot rely on the exemption in paragraph 149(1)(l), since they cannot be registered as charities. The limitation should be more focused, to ensure that the Minister is able to express an opinion that an organization is a charity only where it would meet the criteria for registration. In particular, non-resident organizations that cannot qualify for registration should not be precluded from exemption under paragraph 149(1)(l) merely because they are "charities".

4. Technical Issues

As noted above, there are several issues we wish to raise regarding the July 18, 2005 legislative proposal.

(a) Control

The rules for the designation of registered charities continue to be a concern. The proposed new 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 include the extended control test applicable to business corporations, so that the test is met not only where there is "direct" control through the election of the board of directors, but also where there is "indirect" control through influence. 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 149(1) and (3) of the draft legislation are ambiguous as they relate to the "double barrelled" test for contributions. In the 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.

(b) Split-Receipting

The July 18, 2005 legislative proposal was to enact changes first announced in December 2002 and further changes announced in December 2003. These changes included those 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 proposed rules raise serious questions from a policy perspective and an implementation perspective:

- **Holding Periods**

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. This rule will be extremely unfair in may 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 complex factual issues, such as ascertaining the fair market value of property. However, we are concerned that the proposed solution is overreaching and could cause many donors to abandon legitimate gifts and create unnecessary disincentives for donors.

For instance, the proposed rules do not recognize that property can be moved within a related group of taxpayers for legitimate reasons within a three-year 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 at fair market value, by denying any subsequent increase in value to the taxpayer who makes a gift. We recommend that in appropriate cases no new holding period 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, there is no such relief for situations involving partnerships. We believe this discrimination is inappropriate and we recommend similar relief, subject to suitable safeguards, in situations involving partnerships.

- **Due Diligence**

Where the donor receives some advantage by making a gift, the eligible amount of the gift is reduced. We agree that this is appropriate. However, the proposed rules also impose significant burdens on qualified donees. The earlier proposal that would have required qualified donees to cross-examine their donors will apparently be abandoned, according to correspondence issued by the Department of Finance last December. We welcome this change and think it is appropriate in the circumstances. We do not condone inappropriate behaviour by donors or registered charities, but we submit that qualified donees, in the absence of actual knowledge, should not be assumed to have issued official receipts for more than the appropriate amount.

We recognize that a balance is required 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.

- **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 that 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, which might otherwise be exposed inadvertently to penalties despite complying with the rules.

RECOMMENDATIONS

The CBA Section recommends that:

1. the incentive for gifts of marketable securities be 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 to commence a consultation process with the charities sector 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. a qualified donee not be subject to penalties for issuing an official receipt for more than the eligible amount, if reasonable enquiry has been made as to the circumstances of the gift, regardless of incorrect information received from the donor;

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

7. the charitable remainder trust initiative be pursued vigorously.

The CBA Section is grateful for the opportunity to present these proposals in the pre-budget process. We look forward to discussing them with the Committee in greater detail.

Yours very truly,

(Original signed by James M. Parks)

James M. Parks
Chair
National Charities and Not-for-Profit Law Section