



August 11, 2010

Gérald Lalonde, Director, Tax Legislation Division
and
Baxter Williams, Director, Personal Income Tax Division
Finance Canada
140 O'Connor St
Ottawa, ON K1A 0G5

Dear Messrs. Lalonde and Williams:

Re: Disbursement Quota Reform – Proposed Refinements

I write as Chair of the Charities and Not-for Profit Law Section of the Canadian Bar Association (the CBA Section). The CBA represents some 37,000 lawyers, judges, notaries, law teachers, and law students from across Canada. One key element of the CBA's mandate is to improve the law.

In our continuing constructive dialogue on Disbursement Quota (DQ) reform, we write now to suggest refinements to the draft legislation. We appreciate Finance Canada's prompt attention to our earlier submissions on the DQ provisions of the *Income Tax Act*. The amendments introduced in the 2010 Federal Budget were welcomed with enthusiasm by the charity community and their advisors.

In our view, the following amendments would clear up remaining ambiguities in the draft legislation:

1. We propose that paragraph 149.1 (4.1)(a) be amended to provide that a charity's registration may be revoked if it has entered into a transaction (including a gift to another registered charity) and it may reasonably be considered that a purpose of the transaction was to avoid or delay unduly the expenditure of amounts on charitable activities.

The term "transaction" is very broad. For example, it could include an endowed gift from a donor or a transfer of an endowment from one charity to another. A purpose of such gifts or transfers would be to hold the corpus of the gift for a period of time or even forever.

Presumably, this provision is not intended to prevent donors from making long-term restricted gifts or endowments, nor is it intended that a charity receiving the gift would be precluded from transferring it to another charity which would continue to hold it in accordance with its original terms.

Secondly, it should not be applied to funds which a charity sets aside to create an internal endowment from time to time. It would be helpful to clarify that the provision is not intended to catch such gifts or transfers.

If the proposed amendment is retained, we suggest examples, if given, clarify that the provision is not intended to frustrate the transfer of property (in the form of an endowed gift from one charity to another charity) where the intent is for the recipient charity to receive the gift property with the same terms to which the original recipient charity was subject.

There is also potential uncertainty on what is meant by “to avoid or delay unduly”. It would be useful to clarify those terms. The Technical Notes to the draft legislation could provide examples of the types of transactions that constitute the “harm” the provision is intended to prevent.

2. In view of the changes proposed in paragraph 149.1(4.1)(a), the scope of paragraph (b) should also be reconsidered. Under current paragraph 149.1(4.1)(b), the recipient charity is equally at risk if it is “acting in concert” with the transferor charity. It is not clear whether “acting in concert” is different from not dealing at arm’s length, but presumably it is or different terminologies would not be used. It now seems that both paragraphs 149.1(4.1)(b) and (d) could apply to a recipient charity, if it either acts in concert (or worse, it is reasonable to consider that it is so acting), regardless of whether it spends the money it receives, or if it does not necessarily act in concert but is not dealing at arm’s length with the transferor, and does not spend the money. The double-barrelled problem of determining whether two charities are acting in concert (or can be considered to be doing so) or not dealing at arm’s length compounds the problem.
3. If the mischief is addressed by paragraph 149.1(4.1)(a) as we believe, there is no need to add paragraph 149.1(4.1)(d). There was a DQ obligation for inter-charity transfers in to protect the 80% DQ applicable to receipted donations. Now that the 80% DQ for receipted donations is eliminated, there is arguably no need for this provision for inter-charity transfers. The only DQ advantage to be attained through inter-charity transfers is that this could help the transferor charity meet its 3.5% DQ. There are already penalties for abusive inter-charity transfers and paragraph 149.1(4.1)(a) calls for deregistration for those transfers.
4. We propose that ss. 149.1(4.1) be amended to add new paragraph (d). Currently, a registered charity is deregistered if it has received a gift from another registered charity with which it does not deal at arms length, and has not expended 100% of that gift before the end of the next taxation year in addition to its disbursement quotas for those taxation years, either on its own activities or by way of gifts to other qualified donees which are at arms length to it. There should be an exception for a gift which is a designated gift.

This provision needs to be clarified, particularly concerning what is meant by “non-arms length”. The definition of non-arm’s length in the *Income Tax Act* (Canada) does not fit well with non share capital organizations. Use of the term often leads to confusion about how to determine whether one charity deals at arm’s length with another charity;

We also propose including examples of the harm to be addressed. A transfer from a parallel foundation to a hospital fulfils what the foundation is set up to do (i.e. support the hospital) and meets the foundation’s charitable purpose. Subsequent expenditure by the hospital meets the hospital’s own charitable purpose of providing health care. It is not clear whether an anti-avoidance rule is necessary in these circumstances.

5. Proposed paragraph 149.1(4.1)(d) applies only where there has been an inter-charity “gift”. Proposed ss. 248(40) provides that the split-receipting concept of gift does not apply to inter-charity transfers. This section appears to serve no useful purpose now that the enduring property concept is to be repealed. The term gift is unnecessarily restrictive if you proceed with this provision and consideration should be given to adopting “grant or gift” or other language that avoids this problem.

We would welcome the opportunity to discuss these proposals at greater length. Elena Hoffstein chairs the CBA Section’s Disbursement Quota Committee. Please do not hesitate to contact Elena (ehoffstein@fasken.com) or me (tcarter@carters.ca) should you have any questions or if you would like to discuss these proposals.

Yours truly,

(original signed by Rebecca Bromwich for Terrance S. Carter)

Terrance S. Carter
Chair, National Charities and Not-for-Profit Law Section