Le Comité mixte sur la fiscalité
de l'Association du Barreau canadien
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Comptables professionnels agréés du Canada

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Le 13 octobre 2015

Monsieur Brian Ernewein
Directeur général, Direction de la politique de l'impôt
Ministère des Finances du Canada
90, Elgin
Ottawa (Ontario) K1A 0G5

Objet : Avant-projet de loi du 31 juillet 2015 – Règles sur le don à un organisme de bienfaisance

Monsieur,

Vous trouverez ci-joint un mémoire portant sur l'avant-projet de loi du 31 juillet 2015 concernant les règles sur le don à un organisme de bienfaisance.

Nous vous remercions de l'attention que vous porterez à cette question. Les discussions ayant abouti au présent mémoire, de même que sa rédaction, ont bénéficié de l'apport de plusieurs membres du Comité mixte ainsi que d'autres spécialistes de la fiscalité, notamment :

Bruce Ball (BDO Canada)
Kenneth Keung (Moodys Gartner Tax Law LLP)
Kim G C Moody (Moodys Gartner Tax Law LLP)
Pam Prior (KPMG)
Josh Schmidt (Moodys Gartner Tax Law LLP)

Nous espérons que vous trouverez nos commentaires utiles. Nous serions heureux d'en discuter plus avant au moment qui vous conviendra.

Nous vous prions d'agréer, Monsieur, nos salutations distinguées.

Janice Russell
Présidente, Comité sur la fiscalité
Comptables professionnels agréés du Canada

K. A. Siobhan Monaghan
Président, Section du droit fiscal
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Cc : Alexandra MacLean, directrice, Législation de l'impôt, Direction de la politique de l'impôt, ministère des Finances
Gabe Hayos, vice-président, Fiscalité, CPA Canada

JULY 31, 2015 DRAFT LEGISLATION – CHARITABLE GIFTING RULES JOINT COMMITTEE COMMENTS

A. PUBLIC COMPANY SHARES NOT ON A DESIGNATED EXCHANGE

Under the current rules in paragraph 38(a.1) of the *Income Tax Act* (the "Act"), a taxpayer's taxable capital gain for a taxation year from the disposition of a property is equal to zero if the disposition is the making of a gift to a qualified donee of a share listed on a designated stock exchange or a share of the capital stock of a mutual fund corporation. Proposed paragraph 38(a.4), in conjunction with proposed subparagraph 38.4(1)(a)(i) of the Act, proposes an additional exemption for dispositions of shares of the capital stock of a private corporation to a qualified donee. However, there are some corporations resident in Canada that neither meet the definition of public corporation nor private corporation in subsection 89(1). Two examples are a public corporation that is not listed on a designated stock exchange (for example a capital pool corporation or a corporation listed on the London Stock Exchange's AIM market) and a corporation (again, not listed on a designated stock exchange) that is controlled by a public corporation. It is not clear to us why the proposed exemption does not apply to this other group of share investments.

Recommendation

We recommend that the the proposed exemption in proposed paragraph 38(a.4) be extended to shares of any Canadian corporation whether or not listed on a designated exchange.

B. LIMITATION TO CANADIAN CORPORATIONS AND REAL ESTATE

Proposed paragraph 38.4(1)(a) of the Act limits the property for which an exemption is available to shares of a private corporation (which means that the corporation must be resident in Canada) and real or immovable property situated in Canada. We cannot discern the policy intent to limit the transferred property to private corporations that are residents of Canada or real or immovable property situated in Canada.

Recommendation

We recommend that the proposed exemption in proposed paragraph 38(a.4) be extended to the shares of the capital stock of any corporation (other than a property referred to in paragraph 38(a.1)) regardless of where resident and to any real estate, regardless of where situate.

C. PARTNERSHIP ADJUSTED COST BASE CALCULATION

Subparagraph 53(1)(e)(i) of the Act adds to the adjusted cost base of an interest in a partnership the taxpayer's share of the income of the partnership for each fiscal period. However, in order to reflect the appropriate "tax-paid" basis, clause 53(1)(e)(i)(A) modifies the computation of income to ignore the taxable capital gain inclusion rules set out in paragraph 38(a) and 38(a.1) to (a.3).

Recommendation

We recommend that proposed paragraph 38(a.4) be added to the list of excluded provisions in clause 53(1)(e)(i)(A) of the Act.

D. AMBIGUITY WHEN PARTNERSHIP DISPOSES OF PROPERTY

It is unclear whether the exemption in proposed paragraph 38(a.4) applies where a partnership disposes of shares of a private corporation or Canadian real estate to an arm's length purchaser, and the partner makes a cash donation of his share of the proceeds within 30 days of the disposition. We think that it should, but note that it is not clear that the disposition is that of the partner (rather than the partnership) for the purposes of proposed section 38.3 and subsection 38.4(1) of the Act.

When a partnership disposes of property, for purposes of computing the partners' income, subsection 96(1) treats the partnership as a separate person. In particular, paragraphs 96(1)(c) and (f) require that the partnership be treated as having disposed of the property but each partner's share of the partnership income be treated as income of the partner from that source. However, under general legal principles, a partner carries on the activities of the partnership and the Act is interpreted in a manner consistent with these principles absent rules to the contrary.

The draft legislation, however, neither expressly deems the partner to have made the disposition, nor deems the partner to have proceeds of disposition from the disposition, for purposes of proposed section 38.3 and proposed subsection 38.4(1). Moreover, the partner may not itself be considered to have received an amount of money as proceeds of disposition.

Thus, while the partner has a capital gain from the disposition, it is not clear it is a capital gain from the partner's disposition of property as required in the preamble to proposed section 38.3 and subsection 38.4(1). Similarly, the money is received by the partnership as proceeds of disposition (see element B(B) in the formula in proposed subparagraph 38.3(a)(i)) and the proceeds of disposition are those of the partnership not the partner (see element D in the same formula).

We suggest that, for the purposes of proposed section 38.3 and subsection 38.4(1), where a partnership disposes of private corporation shares or Canadian real estate, each partner of the partnership be treated as having disposed of a proportionate share of the property, to have received a proportionate share of any money received by the partnership as proceeds of disposition of the property and to have proceeds of disposition of the property equal to its proportionate share. This should allow these proposed sections to be read in harmony with subsection 96(1) and the scheme of the Act as it relates to the taxation of partnerships.

Request/Recommendation

We recommend that proposed section 38.3 and subsection 38.4(1) be amended to expressly state that the disposition of relevant property by a partnership is deemed to be the *pro rata* disposition, proceeds of disposition and receipt of money by each partner based on each partner's share of the income of the partnership for the purposes of those sections.

E. ISSUE WHERE PROPERTY IS HELD BY CERTAIN TRUSTS

It appears that there will be barriers to claiming the exemption for property held by a trust. Consider the following example to illustrate the issue.

Mr. A owns real estate as capital property in addition to other property. In drafting his will, he has two main goals: to ensure that income from his property is used to support his surviving spouse and to ensure that his capital is maintained and gifted to charity at the time of his spouse's death.

When Mr. A dies, his property will pass to a spousal trust prescribed under his will on a tax deferred basis under subsection 70(6). At the time of Mrs. A's death, the trust will be deemed to have disposed of the property and reacquired it at fair market value. At some point shortly after her death, the trust will sell the property and gift the proceeds to charity in accordance with the terms of the trust. Assume that there is a gain on the deemed disposition arising on Mrs. A's death.

As the deemed disposition arises in a trust under subsection 104(4), proposed subparagraph 38.4(1) will not apply. Under proposed subparagraphs 38.4(1)(b)(ii) and (iii), the rules only apply to gains arising from a sale to an arm's length person or partnership. In this situation, that disposition is the second disposition (i.e., after the deemed disposition on Mrs. A's death) and it will not be the disposition that gives rise to a capital gain except to the extent that the property appreciates in value between the time of death and the time of sale.

Even if the property is disposed of before the death of Mrs. A, it will not be possible to gift the property proceeds before she dies because under the terms of the trust the capital needs to be preserved until her death. It would appear that the exemption would be available only where the trust sells the property, Mrs. A dies and the gift is made, all within the same 30-day period. It is obviously very unlikely that such circumstances will arise.

By way of contrast, if the property is left directly to Mrs. A and her will provides for a gift from the proceeds from the sale of the real estate, the gain will qualify for the exemption under the estate gift provisions.

There are common and *bona fide* non-tax reasons for establishing a trust on death (such as providing for an individual who is not competent on financial issues, providing for a main beneficiary who is mentally incompetent or to safeguard assets). It is not apparent why the exemption should be lost where a trust must be used for *bona fide* non-tax reasons.

Recommendation

We recommend that the rules be expanded in a manner similar to the rules in subparagraph 38(a.4)(ii) so that a deemed disposition under paragraph 104(4)(a) is taken into account in the same manner as the deemed disposition rules referenced in the proposed rules under section 70. Further, the donation rules should be amended more generally to provide for an election into rules similar to subsection 118.1(5) (i.e., transfer the gift credit to the estate) that will apply to gifts of property by a trust after the death of the life interest beneficiary (to allow a transfer of the gift credit to offset the gains that will be realized under subsection 104(13.4) by the estate of the life interest beneficiary).

F. 30-DAY DEADLINE FOR DONATION

Under the proposed rules, the gift must be made within 30 days of the disposition of the property. From a practical point of view, executors generally liquidate estate property and then seek a CRA clearance certificate before paying out the residue of the estate to beneficiaries (including a charity). Since the liquidation may create taxable income, the CRA can only provide a final clearance after all property has been disposed of. Concerns have been raised that the 30-day period is too short generally, and in the case of an estate gift, the 30-day rule makes the exemption unworkable where a clearance certificate is needed after the eligible property is sold and before the gift is made.

Recommendation

We recommend that the reference in proposed clause 38(a.4)(ii)(D) to "that is made by the estate to a qualified donee not more than 30 days after the subsequent disposition" should be replaced with "that is made by the estate to a qualified donee while the estate is a graduated rate estate". Similarly, the restriction in (A)(I) in element B of the formula in subparagraph 38.3(b)(i) to "within 30 days after the subsequent disposition" should be replaced with "within the time set forth in clause 38(a.4)(ii)(D)".

This is the rule for estate gifts generally, and it is not clear to us why there needs to be a different timing test where an eligible property is sold given the nature of the new estate gift rules enacted last year. Given our recommendation in Section E above, we would also recommend that a more reasonable period to make the transfer of money be adopted for these trusts to enable sufficient time to make the necessary charitable gift.

G. INSTALMENT SALES

We note that the 30 day limitation is inconsistent with the current scheme of the Act which generally permits the deferral of capital gains up to 5 years (and 10 years in some circumstances) on an instalment sale. A taxpayer wishing to take advantage of this capital gain deferral will not be eligible for the capital gain exemption under proposed paragraph 38(a.4) of the Act due to the timing of the receipt of the proceeds. We cannot see a policy reason for denying the proposed capital gain exemption where the taxpayer donates the cash within 30 days of receiving the proceeds notwithstanding the closing of the sale may have occurred well before that receipt. This is particularly relevant in cases of an owner-manager's sale on retirement because the pool of potential purchasers includes a substantial number of buyers who require vendor financing (i.e. young entrepreneurswho need to pay in instalments).

Recommendation

We recommend that you clarify that for the purposes of a reserve taken under sub-paragraph 40(1)(a)(iii), the reference in (A)(I) in the description of element B in the formula in proposed subparagraph 38.3(a)(i) to "30 days after the disposition" means "30 days after the receipt of proceeds in that particular year" and that the reference in element D in the same formula to "proceeds of disposition of property" means "proceeds of disposition received in that particular year".

H. EXTENDING CARRYFORWARD PERIOD

It is possible that the donor may not have sufficient taxable income in the year or in the five-year carryforward period to claim the full donation tax credit. This is particularly relevant in the common case of the retirement of an owner-manager where the value of the business sold is often significantly larger than his or her retirement income over the next five years. In many of these cases, the value of the business sold represents the entirety of the owner-manager's retirement funds. Given the proposed regime exempts the capital gain arising from the disposition of the relevant property, there may not be enough taxable income to absorb the donation tax credit in a five year subsequent period. In cases like these, we think that an extension for 10 years would be appropriate.

Recommendation

We recommend that the carryforward for gifts derived from the proceeds of a sale of private corporation shares and real property be increased to 10 years, similar to the period available for donations of ecological gifts by individuals.

I. DISPOSITION AND GIFT BY GRADUATED RATE ESTATE COVERS BOTH DISPOSITIONS

We understand that under proposed subparagraph 38(a.4)(ii), a graduated rate estate must dispose of the property and make the prescribed cash donation within 30 days of that disposition in order to access the exemption for a deemed disposition under section 70. We interpret proposed paragraph 38.3(b) as allowing the exemption in the deceased's final return in accordance with the ratio of the amount of the cash donated by the graduated rate estate to the proceeds of disposition of the property by the graduated rate estate. Correspondingly, we interpret proposed paragraph 38.3(a) as allowing the exemption in the graduated rate estate's return in respect of any gain that it realizes on the same property (i.e., the proceeds that it receives on the sale of the property in excess of the fair market value at the time of death), in accordance with the same ratio.

Request

We ask you to clarify whether you agree with the above interpretation.

J. APPLICABILITY TO DEEMED PROCEEDS

Proposed clause 38.3(a)(i)(B) limits the portion of the capital gain exemption based on "the amount of money received by the taxpayer, as proceeds from the disposition, prior to the making of the gift". It is unclear whether this includes deemed proceeds or takes into account deemed adjustments to proceeds. Consider the following two examples:

Example 1 (cash proceeds re-characterized as proceeds of disposition):

A private corporate subsidiary redeems low paid-up-capital shares held by its arm's length, unaffiliated, corporate shareholder for cash, and the facts and circumstances are such that subsection 55(2) applies to re-characterize the resulting subsection 84(3) deemed dividend as proceeds of disposition of the share. The corporate shareholder then donates all of the redemption proceeds to a qualified donee within 30 days.

Per subsection 84(9), the redemption is considered a disposition of shares by the corporate shareholder to the corporate subsidiary and paragraph (j) of the definition of proceeds of disposition in section 54 does not operate to exclude the amount from proceeds of disposition (because subsection 55(2) applies). We think that proposed subsection 38.4(1) should apply because (a) the property disposed of is shares of a private corporation, (b) the disposition is to an arm's length, unaffiliated person, and (c) the corporate shareholder has not acquired in the year the redeemed shares or substituted shares or property that derives its value from those redeemed shares. The corporate shareholder should therefore be entitled to claim a capital gain exemption pursuant to proposed paragraph 38(a.4) and proposed paragraph 38.3(a), as long as the cash redemption proceeds that are re-characterized as proceeds of disposition under subsection 55(2) can be considered "the amount of money received by the taxpayer, as proceeds from the disposition" in item B(B) of the formula in proposed subparagraph 38.3(a)(i).

Recommendation

We ask you to clarify whether you agree with the above interpretation.

Example 2 (cash proceeds re-allocated as proceeds of disposition):

A taxpayer sells a package of Canadian real estate and other property to an arm's length purchaser, and the taxpayer donates the proceeds from the Canadian real estate to a qualified donee within 30 days. However, it can be reasonably regarded that the consideration for the disposition of the Canadian real estate is different than that in the purchase and sale agreement, such that section 68 applies to re-allocate the proceeds of disposition pertaining to the Canadian real estate. We think that the re-allocated proceeds, rather than the actual proceeds pursuant to the legal agreement, constitute "the amount of money received by the taxpayer, as proceeds from the disposition" in element B(B) of the formula in proposed subparagraph 38.3(a)(i). However, any such reallocation will likely not occur until long after the donation has been made.

Recommendation/Request

We ask you to clarify whether you agree with the above interpretation. We also recommend that cases where the reallocation increases the gain, the taxpayer be given an opportunity to make an additional donation, within 30 days of the reallocation, in order to reduce the gain.

K. OVERLY BROAD ANTI- AVOIDANCE RULES – "ACQUIRED IN THE TAXATION YEAR"

Proposed subparagraph 38.4(1)(c)(i) will deny the exemption where various parties acquire the property during the year of disposition. We are concerned that this provision is too broad and will catch a wide variety of transactions where the denial of the exemption would be inappropriate. For example, basic reorganizations that involve a disposition of property before a sale will result in a denial of the exemption.

Further, a GRE will always be caught by this rule in its first year because it acquires all of its property as a consequence of the deceased's death. Perhaps you read this rule as not applying to a GRE's acquisition on the basis that the entire scheme requires such a reading in order to permit GREs to properly function in their first year. If so, would it then apply where the deceased acquired the property within the year prior to his or her death? If so, would this change where a taxpayer dies within the first year of acquiring the property as a consequence of his or her spouse's death, as would happen in the common case of spouses dying together (typically the older is deemed at law to have predeceased the younger in cases of simultaneous death)?

Recommendation

We recommend that this anti-avoidance rule be redrafted so that it only applies to transactions of concern. In particular, proposed clause 38.4(1)(c)(i) should only apply where the property is acquired after the time of disposition, not at any time during the year.

L. OVERLY BROAD ANTI- AVOIDANCE RULES – "ALL OR ANY PORTION OF"

The use of the wording "acquires [property]… all or any portion of" in proposed subparagraph 38.4(1)(c)(i) and paragraph 38.4(3)(a) is impractical when the property disposed of is real or immovable property. An owner of real property is regularly required to incur capital expenditure in respect of the property in order to maintain it. The wording in proposed paragraph 38.4(3)(a) is such that a donor is ineligible for the capital gain exemption under paragraph 38(a.4) if any capital expenditure was made in respect of the real property disposed of within the taxation year, because the donor would be considered to have acquired "any portion" of the property.

Proposed paragraph 38.4(2) claws back the entire capital gain eligible for the exemption if any portion of the gifted property is subject to the anti-avoidance rules. This seems overly punitive.

Recommendation

We recommend that this anti-avoidance rule be redrafted so that it only applies to transactions of concern. In particular, proposed subparagraph 38.4(1)(c)(i) and paragraph 38.4(3)(a) should only apply where the portion of the property is acquired after the time of disposition, not any time during the year.

M. OVERLY BROAD ANTI- AVOIDANCE RULES – PROPERTY DERIVING ITS VALUE FROM THE PROPERTY

The draft legislation makes three references[1] in the anti-avoidance rules to property that derives its value from the property that was sold.

Our primary concern is that the phrase "derives its value from the property" is very imprecise. Does this refer to a situation in which a property derives any portion of its value from the property? Or is it limited to situations where the property derives all, or substantially all, of its value from the property?

If the condition is met where only a portion of a property's value is derived from the property disposed of, other concerns arise. In particular, what if a large, public company acquires the property? Are the shares of that public company now property that derives its value from the acquired property? In that case, the anti-avoidance rules are triggered if the taxpayer, anyone non-arm's length to the taxpayer, the qualified donee or anyone non-arm's length to the qualified donee acquires shares of that public company at any time within 60 months of the disposition. That seems inappropriate where the public company derives most of its value from other assets and has no connection to the taxpayer or the qualified donee.

It would also be very difficult to monitor this situation. Taxpayers neither can nor will monitor the investments held by all taxpayers who are non-arm's length. For example, adult siblings will have no knowledge about (or right to inquire about) property held by each other. Similarly, in most cases taxpayers will not control or influence the qualified donee. Thus, the anti-avoidance rule can be triggered without any improper behaviour by the taxpayer.

Further, "property that derives its value from the property" could include commonly used property interests such as leaseholds and licenses. If a taxpayer who owns a Canadian real or immovable property has leased or licensed the property to a non-arm's length entity prior to the disposition (a frequent structure for holding real estate for business use), this would prevent the taxpayer from taking advantage of the capital gain exemption because a non-arm's length person of the taxpayer has acquired a lease, which is a property that derives its value from the property, within the taxation year. Moreover, a taxpayer who disposes of real or immovable property to an arm's length purchaser and subsequently leases it back at fair market value rent (again a common sale structure for real estate) will be prevented from claiming the capital gain exemption for the same reason.

Recommendation

We recommend that the limitation be restricted to property that derives significant value from the property sold or that is held by a person who has a significant interest in the issuer of the property.

[1] In proposed clause 38.4(1)(c)(i)(C) (where the taxpayer or non-arm's length or affiliated person or partnership acquires such property in the year of the gift, the exemption is denied); in proposed subparagraph 38.4(3)(a)(iii) (where the taxpayer or non-arm's length or affiliated person or partnership acquires such property in the year of the gift and for some reason the exemption was not denied, a deemed gain arises under 38.4(2)); and in proposed subparagraph 38.4(4)(c)(i)(C) (where the taxpayer or non-arm's length or affiliated person or partnership acquires such property within 60 months after the disposition, a deemed gain arises under 38.4(2)).