Recent Tax and Legal Developments

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Two Recent Cases and a Law Reform Initiative

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Readers of this journal will be interested in two recent cases, one Canadian and one English, and a law reform initiative.

Uni Association v. *Minister of National Revenue*

In December 1992 the Federal Court of Appeal gave judgment in *Canada Uni Association* v. *Minister of National Revenue*. The Association was formed in 1991 with the purpose of promoting Canadian unity[1] and was denied charitable status by Revenue Canada. The Court upheld this decision in an oral judgment rendered at the conclusion of the hearing, relying on the doctrine that trusts for political purposes cannot be charitable. The Court chose to follow *Toronto Volgograd Committee* v. *M.N.R.*, [1988] 3 F.C. 251 (C.A.), 88 D.T.C. 6192, where the purpose was the reduction of international tension, rather than *Native Communications Society of B.C.* v. *M.N.R.*, [1986] 3 F.C. 471 (C.A.), 86 D.T.C. 6353, where the purpose was the promotion of communications by native organizations and the dissemination of information about native peoples. In doing so it probably put an end to the possibility that the *Native Communications Society* case could spawn a "distinctly Canadian" definition of charity. In fact, the Court held that *Native Communications Society* is now to be distinguished on the grounds that it involved native peoples "who hold a special position in Canadian society", and it has yet again adhered rigidly to the political purposes doctrine. In this context the result is that the purposes of "inform[ing] Canadians concerning the unique geographic, social, cultural and linguistic nature of Canada", and of establishing "direct personal communications between citizens of Canada's distinct groups and regions", "however beneficial they may be" (in the words of Marceau J.A.), are not charitable, either as the advancement of education or as a purpose beneficial to the community in a way the law regards as charitable.

The decision here is interesting for two further reasons. First, the Association did not pursue political purposes as those are generally understood; its objects were not to further the interests of a political party, to bring about legislation, or to effect changes in government policy. If anything, one could argue that the purposes would support political choices already made and being carried out as official policy, and the number of charities that do that are legion. Marceau J.A. did not specify why the Association was political; one is left to speculate that its involvement in a controversial issue was the problem, yet that was explicitly rejected by the Court as a ground for denying charitable status under the political purposes doctrine in *Everywoman's Health Centre Society* v. *M.N.R.*, [1992] 2 F.C. 52 (C.A.), 92 D.T.C. 6001 (see the "Case Comment" in (1992), 11 *Philanthrop.* No. 1, pp. 3-14). Second, the Court rejected an argument that charitability should be decided according to the law of Ontario which was, arguably, broad enough to consider the Association's purposes to be charitable. It held that the appropriate definition of "charitable" was that given by the federal courts to the word as used in the *Income Tax Act*.

This represents a clear recognition of a federal law of charities which was only implied in previous decisions. The Court is probably correct in this. Whatever arguments might have been available in the past to suggest that the provinces can decide what "charity" means in the *Act*, the decision of the Supreme Court of Canada in *Queen in Right of British Columbia* v. *Henfry Samson Belair Ltd.*, [1989] 2 S.C.R. 24, 59 D.L.R. (4th) 726, makes it clear that the provinces cannot, by legislation (or presumably also by judicial decision), determine the meaning of terms in federal statutes so as to alter the law in an area of exclusive federal jurisdiction. The *Henfry Samson Belair* case dealt with deemed trusts in bankruptcy, but the constitutional principles are, it is submitted, equally applicable here.

Harries and Others v. *The Church Commissioners*

The latest word from the English courts on "social investing" by trustees is contained in *Harries and Others* v. *The Church Commissioners*, [1992] 1 W.L.R. 1241 (Ch.D.). In Ontario this issue excited controversy a few years ago regarding the question of whether trustees of pension funds were at liberty not to invest in South Africa if, by agreeing to divest themselves of their holdings, they provided a lesser return for beneficiaries. [Ontario has resolved the issue by statute. See *South Africa Trust Investments Act*, R.S.O. 1990, c.S. 16.] In England the general point was dealt with in *Cowan* v. *Scargill*, [1985] Ch. 270, a case involving the mineworkers' pension fund.

In *Harries* the problem was raised, not by persons concerned to enhance the rate of return, but by clergy advocating more, not less, "ethical" investing. The Bishop of Oxford and others objected to the fact that the Church Commissioners attached "overriding importance" to financial return and gave insufficient

weight to the need to invest in ways that would actively promote Christianity. Vice-Chancellor Sir Donald Nichols' judgment had two parts. He dealt first with general principles, noting that charity trustees, and indeed all other trustees, should invariably be guided in investment decisions wholly by the need to obtain the maximum return "consistent with commercial prudence". He then sketched out exceptions to this general rule which he thought represented "comparatively rare" categories. These included situations where the investment conflicted with the particular charitable purpose (he used the example of a cancer society investing in tobacco shares), or where an investment might make the potential beneficiaries of a charity unwilling to accept its largesse; however even in these instances the charity's return would probably not be affected because a wide range of prudent and productive investments would still be available. It was a very different matter for the trustees of a charity to make investment decisions generally with some criteria other than investment return in mind: "by definition, investments are held by trustees to aid the work of the charity in a particular way: by generating money". If "ethical criteria" are to be investment criteria, then the charity must be set up for that purpose.

The remainder of the judgment considered the particular application. The statute governing the work of the Church Commissioners required them to invest to provide an income which would then be used principally for the support of the clergy, and this they did. Yet, perhaps inconsistently, the Vice-Chancellor also gave as a reason for refusing the application the fact that the Church Commissioners "do have an ethical investment policy". There was a reasonably broad range of investments that they refused to make and, in addition, some of the capital went into small business ventures in areas of high unemployment. The Court, after describing the investment policy, insisted nonetheless that nothing in it was "inconsistent with the general principles" expounded. At one and the same time, therefore, the Court disavowed social investing as a general approach and approved it in particular cases.

The decision in *Harries* has drawn some criticism (see [1991] *Conveyancer* 115-118) on the grounds that as charities can, and indeed should, distribute "ethically" they should also be permitted to invest that way. While at first glance this seems an attractive argument, there are a number of reasons why the Court may have got it right. First, the distribution of income is not expected to result in "returns" of any kind. Second, if capital is not invested well there will be little income for distribution. As a result there may well be cases where the purposes of the charity, as envisaged by its creator, can only be carried out for a limited period of time before the money runs out. This point is highlighted by *Harries* itself, for it no doubt influenced the judge that the Commissioners spent 85 per cent of income in providing clergy stipends which were nonetheless not very high. Third, ethical investing can always be provided for in the

trust documents; in *Harries* the governing statute was not only silent on the point, it effectively precluded such actions by trustees by requiring them to provide primarily for the clergy. An investment policy that, in the opinion of the Court, did not do so would probably be a breach of trust.

Report on Non-Charitable Purpose Trusts

In December 1992 the Manitoba Law Reform Commission released its *Report on Non-Charitable Purpose Trusts*. The Report advocates sweeping reform of this area of the law which, effectively, would assimilate the law of charitable and non-charitable purpose trusts. Traditional objections to the latter would be answered by the need for purpose trusts to include nominated "enforcers" who would be supervised by the court and by also giving the court a scheme-making and variation jurisdiction. It should be noted that the perpetuities objection to non-charitable purposes is already met by Manitoba's prior abolition of the rule. The significance of the *Report* for those interested in charity, of course, is in the fact that the often less than coherent distinctions drawn by the general law between what is charitable and what is not will no longer have practical effect in the area of the trust's validity (although this will change nothing in the tax-exemption area). One might ask why the Commission did not go one step further and advocate a complete assimilation of purpose trust law. As matters now stand, if the proposal is adopted, the courts of that province will be doing the same thing with charitable as non-charitable trusts, under different names e.g., *cy-près* for the former, variation for the latter.

FOOTNOTE

1. On March 29, 1993, the Federal Court of Appeal was scheduled to hear the appeal of a Quebec organization dedicated to separatism.

Tax Changes Affecting Registered Charities

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Proposed Income Tax Amendments

In the draft technical amendments to the *Income Tax Act*, released by the Department of Finance on December 21, 1992, there were some changes that, if enacted, will affect registered charities.

Firstly, in order for a registered charity to maintain its registration under the *Income Tax Act* (the *Act*) it is required to expend on charitable activities and/or gifts to qualified donees an amount (disbursement quota) that is equal to a specified proportion of the amounts for which charitable donation receipts were issued in the preceding year. (In the case of a charitable foundation, 4.5 per

cent of the fair market value of its endowment funds as determined under the provisions of the *Act* and *Income Tax Regulations* must be disbursed.) However, in arriving at the amount of donations for which charitable donation receipts are issued in the preceding year, certain amounts, such as a bequest and a gift of property subject to a direction that it or property substituted therefor be kept for a minimum of 10 years, can be excluded. Because of the Department of Finance's concern that, when the funds represented by the two types of gifts referred to above are actually expended the disbursement quota is distorted, an amendment is proposed to provide that the amounts of such donations would be included in the disbursement quota when the funds are expended. This provision would be effective for taxation years beginning after 1992. One of the principal difficulties with this provision is that it may be difficult to determine when the funds representing the gifts in question *are* expended.

The second proposed change has the effect of precluding a "double counting" for purposes of the disbursement quota when the amount accumulated for a specific purpose which has been approved by the Minister of National Revenue is actually expended for the intended purpose. Under the existing provision of the *Act*, such accumulated property is deemed to have been expended on charitable activities in the year that it is accumulated. The amendment will preclude such accumulations from being considered as expenditures for the purpose of the disbursement quota when they are actually expended. This provision would also be applicable to taxation years commencing after 1992.

It is also proposed that after December 21, 1992 the books of account and records of a registered charity and registered Canadian amateur athletic association must contain sufficient information to permit Revenue Canada to determine whether there are any grounds for the revocation of the entity's registration. It is by no means clear what this new requirement would entail although it does indicate that the new requirement is in addition to the other information that is already required under the *Act*.

Revenue Canada, Taxation

The final step in the revocation of the charitable status of an entity is the publication of the required notice in the *Canada Gazette*. Commencing in late 1992, Revenue Canada, Taxation has expanded its reasons for such revocation to include a registered charity's failure to file the required information return. In this case paragraph 168(1)(c) of the *Act* provides that the Minister of National Revenue can revoke registration. Previously, when a charity had its registration revoked because of its failure to file such a return the cause was not specifically identified. The statutory basis referred to in the notice published in the *Canada Gazette* was simply paragraph 168(1)(b) of the *Act* which

provides for revocation of the registration of a charity which has ceased to comply with all the requirements for registration.

University Foundations Act

Bill 68, an *Act Respecting University Foundations* (the *Foundation Act*), was passed by the Ontario legislature and received royal assent on November 5, 1992. In summary, the *Foundation Act* provides that a foundation can be established for each university that is prescribed by regulation under this *Act*. At the time of the enactment of the *Foundation Act*, there were 19 prescribed Ontario universities including the Ontario College of Art and Ryerson Polytechnical Institute. Each foundation is a Crown agency within the meaning of the *Crown Agency Act*.

The establishment of such a foundation provides a mechanism whereby substantial gifts by donors can be made indirectly to a university without restricting the tax benefit to 20 per cent of the donor's income for tax purposes, whether it is the tax credit allowable to individuals or a tax deduction permitted to a corporate donor. Under the *Income Tax Act* the general rule is that an individual donor can claim a tax credit for donations made to registered charities and other qualified donees but only to the extent of 20 per cent of his or her income for tax purposes; however, certain gifts to the Crown are not subject to such a limitation. By establishing university foundations, the new *Act* means that gifts to such entities are treated as gifts to the Crown in respect of which there is no restriction on the amount of the tax benefit for an individual donor. (The same is true with respect to a corporate donor except that a deduction from taxable income rather than a tax credit is available.)

[Editor's note: for further information on university foundations see also Blake Bromley, "Parallel Foundations and Crown Foundations" pp. 37-52.]

Goods and Services Tax

The Minister of Finance, The Hon. Don Mazankowski, tabled a Notice of Ways and Means on December 10, 1992, which includes GST simplification measures for charities, not-for-profit organizations, the MUSH sector and small businesses. These measures have not yet been enacted.

Briefly they include:

1. *Volunteer Reimbursements/Allowances*
   Retroactive to January 1, 1991, charities will be permitted to claim rebates and input tax credits with respect to reimbursements and allowances paid to volunteers. The rebate or input tax credit is available on expenses incurred by, and allowances given to, volunteers for purposes that relate to the charity's activities.

2. *Meals and Entertainment Expenses*
Charities, including universities and hospitals, will be entitled to claim 100 per cent of input tax credits with respect to meals and entertainment attributable to their taxable supplies—there will be no restriction to 80 per cent, as is the case with other GST registrants.

3. *Taxable Supplies of $500,000 or less*
Charities, non-profit organizations, the MUSH sector and small businesses with $500,000 or less in taxable sales will be permitted to claim input tax credits and rebates based on 7/107ths of their total GST taxable purchases.

   This recovery will be greater than the actual GST paid as the factor is based on the total invoice price including unrecoverable retail sales tax and gratuities. This measure was to take effect for GST returns (and rebates) filed on or after April 1, 1993. No election need be filed with Excise to claim input tax credits or rebates on this basis.

4. *Increased Threshold for Small Suppliers*
A small charity will no longer be required to register for GST purposes if its gross revenue (grants, subsidies, investment income, business income, etc.) as filed on Form T3010, for either of its previous two fiscal years was $175,000 or less, regardless of the threshold of its taxable sales. A charity which exceeds the $175,000 gross revenue test may continue to base its GST registered status on the small-supplier threshold. Thus, where the charity makes less than $30,000 through taxable transactions in the four preceding quarters there is no need to register.