Recent Tax Developments

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1997 Federal Budget Changes

The Federal Government has recently provided increased support to the charitable sector through the income tax system. In 1995, donations of ecologically sensitive land were exempted altogether from net-income limitations. The 1996 Federal Budget encouraged greater charitable giving by increasing the annual limit for donations from 20 per cent to 50 per cent of net income and providing a further incentive for gifts of appreciated capital property. Also pursuant to the 1996 Federal Budget, the annual limit for all donations made in the year of death and the preceding year was increased to 100 per cent of net income.

The 1997 Federal Budget also includes several proposals relating to charitable donations and charities.

Summary

(i) *Annual Limit*

For taxation years starting in 1997, the annual limit on donations will be set at 75 per cent of net income for individual and corporate donors and will be uniformly applied to all charities. This raises the general annual-income limit by one half, from 50 per cent to 75 per cent for donations to most charities. It also eliminates the preferential treatment granted to Crown Agency foundations which previously had a 100-per-cent annual-income limit.

Donations in the year of death and the preceding year, as well as donations of ecologically sensitive land and Canadian cultural property, will still be eligible for the 100-per-cent annual limit.

(ii) *Gifts of Appreciated Property*

The annual limit will also be increased by 25 per cent of the amount of taxable capital gains or recapture realized on a donation of appreciated capital property.

Where gifts of appreciated capital property are made, the donor will have an income inclusion for any taxable capital gain and, in the case of depreciable property, recaptured capital cost allowance (i.e., tax depreciation) that is realized. In certain instances, donors were unable to offset the resulting tax liability as a result of the annual income limit and in the case of individual donors, the limitation on the credit for the donation. The tax on these income inclusions often reduced incentive for this type of giving for all but very high income earners. The Budget proposal to increase the annual income limitation, by 25 per cent of the capital gain and/or recaptured capital cost allowance, should alleviate this problem.

(iii) *Gifts of Publicly Traded Securities*

The 1997 Federal Budget provides a significant incentive for donating publicly traded securities to charities, other than private foundations. The income inclusion rate for capital gains resulting from donations of such securities will be reduced from 75 per cent to 37.5 per cent, for gifts made after February 18, 1997 and before January 1, 2002. This proposal will provide a tax saving to the donor of approximately 64 per cent of the value of the donation. After this five-year trial period the effectiveness of the incentive will be evaluated. Based on that evaluation it will be continued or discontinued.

Publicly traded securities include bonds, warrants, and futures, in addition to shares, that are listed on a prescribed stock exchange. A "prescribed stock exchange" includes the Alberta, Montreal, Toronto, Vancouver and Winnipeg stock exchanges as well a number of foreign stock exchanges.

(Individual donors should be cautioned that large gifts of appreciated capital property, including publicly traded securities, may give rise to the alternative minimum tax.)

(iv) *Donations of Ecologically Sensitive Lands*

Effective for donations made after February 27, 1995, the method of valuing donations of easements, covenants and servitude of ecologically sensitive lands will be changed. The value of the donation will now be deemed to be the greater of the fair market value of the easement, etc., otherwise determined, and the amount by which the fair market value of the land to which the gift relates is decreased as a result of the gift. It is anticipated that the value of a gift of easements, etc., of ecologically sensitive lands will be greater under this new method than under the former method.

(v) *Penalty Provisions*

One of the most controversial proposals contained in the 1997 Budget relates to the treatment of gifts of debt and shares of private companies to charities.

The proposals are directed specifically against certain arrangements between charities and taxpayers who do not deal at arm's length with the charity, which Revenue Canada considers to be abusive. These arrangements generally involve a transfer of funds to a private foundation, followed by a loanback to the donor for part or all of the donation, or a purchase of shares or debt of a private corporation that does not deal at arm's length with the donor. As a result of the arrangement, the donor, or a corporation related thereto, has continued to have the use of the funds and also the benefit of a tax credit/deduction for the donation.

Also, where a donor has made a gift of shares or debt of a private corporation that does not deal at arm's length with the donor, Revenue Canada takes the view that an unreasonable benefit is provided to the donor because the donor, or the related corporation, still has the use of the cash, even though the charity may be receiving a market rate of return on the capital received. [For an opposing view of the benefits of this new regulation, see "Dolphins, Tuna and Mudsharks: Reflections on the 'Bre-X Budget' for Charities", p. 27.]

To prevent perceived abuses, the Budget contains proposals that would make a charity liable for a special 50 per cent tax on the amount of non-publicly-traded debt or shares of a person with whom the charity does not deal at arm's length, where the security is acquired after February 18, 1997. The 50 per cent tax will be payable at the time of acquisition of the shares or debt.

The 50 per cent tax will also be imposed where, within five years after a donation to a charity, that charity holds non-publicly-traded debt or shares of the donor, or a person that deals at non-arm's-length with the donor, or where the charity allows any of its property to be used by the donor or any other person who does not deal at arm's length with the donor. In this case both the donor and the applicable person who deals at non-arm's length with the donor are jointly and severally liable, with the charity, for the 50 per cent tax. Also in this case, the 50 per cent tax could apply to a gift made before February 19, 1997, but not where the charity held the aforementioned non-publicly-traded debt or shares or the donor used property of the charity prior to February 19, 1997.

(vi) General Audit and Compliance

To address complaints that inadequate information is available for the public to assess how donations are being used, the Budget includes a proposal to make available to the public all information which a charity must file with Revenue Canada, including:

- governing documents, including the statement of purpose;
- any information required to be provided with the application for registration;
- names of the directors of the charity;
- notification of registration, including warnings and conditions;

- annual information returns filed by the charity;
- notice of a revocation of registration, should it occur, indicating the grounds for revocation.

Also, Revenue Canada plans to augment its audit and compliance resources for charitable organizations in order to be able to monitor the sector more closely. This will include expediting revocations of charitable status and pursuing existing non-arm's length arrangements between charities and taxpayers.