

Quick Reference

What Charities Should Know About Proposed Amendments to the *Income Tax Act*: Gifts to Foreign Entities, Large Gifts and “Split Receipts”

In December 2002, the Department of Finance proposed changes to the *Income Tax Act*. Some of these proposed changes will affect registered charities, as is pointed out in the preceding article, “Comments on Certain Proposed Tax Rules Applicable to Charities: Gifts to Foreign Entities, Large Gifts and ‘Split Receipts’,” by John Loukidelis. The main changes are outlined below.

1. Treatment of gifts to foreign charities that are not considered qualified donees under the *Income Tax Act*.

Proposed amendments would allow for the deregistration of charities that make gifts:

- to foreign entities that are not qualified donees, or,
- for purposes other than carrying out the charity’s charitable activities.

The intent of this change is to ensure that donations for which tax receipts have been issued in Canada are put toward charitable activities.

To avoid difficulties, charities that transfer funds to foreign entities should follow the Canada Customs and Revenue Agency’s administrative policies in this area. First, they should transfer funds to organizations outside of Canada that are not qualified donees only if these organizations are using the funds on behalf of the charity and to carry out the charity’s activities. And, second, they should have a formal written arrangement with individuals or organizations outside of Canada that act on the charity’s behalf. This should spell out the particular duties or activities that the charity wishes the individuals or organizations to perform and should make it clear that the charity continues to direct and control the resources it is transferring.

2. Treatment of “large” gifts.

Under the *Income Tax Act* currently, organizations can qualify as charitable organizations or public foundations (as opposed to private foundations) provided that not more than 50% (75% in certain cases) of the capital contributed or otherwise paid in to the charity derives from one person or from members of a group of people who do not deal *with each other* at arm’s length.

Proposed changes would make it easier for charitable organizations and public foundations to accept large donations without endangering their status – provided the donor deals at arm’s length with the charity’s responsible persons

(e.g., officers, directors, and trustees) and provided that the organization is not directly or indirectly controlled (*de facto* controlled) by a donor who may have contributed more than 50% of the organization's capital.

However, it is not entirely clear how the concepts of *arm's length* and *de facto control* will be applied. While much remains to be clarified on the question of arm's length, there are steps that charities can take to satisfy the matter of control.

To be prudent, a charity's board of directors, who are charged with governing the charity, must fulfill that responsibility. The board cannot and should not delegate its authority except in accordance with the charity's documents of incorporation and by-laws. Even if it delegates its authority, it must still maintain supervisory control over the charity. In other words, the board of directors must remain informed about key aspects of the operation of the charity, including its finances, gift acceptance and receipting practices, fundraising and development efforts, and grant-making activities.

3. Implementation of new rules on "split receipts."

Under the *Income Tax Act* currently, a donor cannot benefit from his or her gift and still claim a tax deduction for that gift. Proposed changes would implement a "split receipt" system so that if a donor makes a gift to a charity and the donor or a person dealing not at arm's length with the donor receives some benefit in return, the donor can claim a tax deduction, the amount of which will be reduced to take into account the value of the benefit he or she received.

However, the drafting of the proposed amendments is unclear and open to interpretation that could cause problems for charities and their donors. For example, it is unclear how well the arm's length concept will operate in the charities context, especially given that the fact of one person making a gift to another is often taken as indicative that they do not deal at arm's length. In addition, charities will need to conduct additional due diligence to ensure that the eligible amount shown on a receipt is correct. The Draft Legislation seems to contemplate that the eligible amount of a gift will be reduced even where the charity does not know that a benefit has been conferred.

The new split receipt system may be of particular concern to those making gifts to religious schools, as it leaves open the distinct possibility that courts in Canada could take the same approach that the U.S. has taken, i.e., that all payments made to independent religious schools are really tuition, not donations or gifts and, as such, are ineligible for charitable tax deductions.