

Recent Tax Developments

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Budget Update

On October 27, 1982, the Honourable Marc Lalonde, Minister of Finance, in his *Statement on the Economic Outlook and the Financial Position of the Government of Canada* indicated the government's intention to release a discussion paper on the tax treatment of charities later in 1982. (It appears that the discussion paper will not be released until early this year.) The discussion paper would not only include commentary on the proposed tax treatment of charities but also the draft legislation which would implement the budget proposals of November 12, 1981 (as modified by the press release dated April 21, 1982). The discussion paper will probably propose that there should be the same distribution rules for both charitable organizations and charitable foundations. In the *Economic Statement*, the Minister of Finance indicated that the new rules will only apply to taxation years commencing after 1983; however, the special rules concerning non-qualified investments which will apply to all charities, will be tied into the date of April 21, 1982 insofar as the transitional rules relating to any shares or debt issued prior to April 22, 1982.

Case Update

A recent case of interest is *Church of Christ Development Company Limited v. M.N.R.*, 82 DTC 1461, where the Tax Review Board considered the real estate investment and mortgage activities of a charity.

Church of Christ Development Company Limited (the "Company") was incorporated in Alberta on September 9, 1957. One of its objects was "To conduct all business for the benefit and profit of the Churches of Christ in Canada" and another was "To deal in shares, bonds, mortgages, real estate, agreements for sale, and other investments that the directors may seem (sic) advisable".

The judgment contains a lengthy review of the evidence. The evidence indicated that the taxpayer extensively developed, bought and sold real estate, held related real estate mortgages and traded stocks and purchased investments in a manner resembling a business. For example, it was found that only approximately \$180,000 out of \$1,300,000 of outstanding mortgages were to members or adherents of the Church or had qualified on compassionate or charitable grounds. The balance, according to the evidence, were standard commercial mortgages. It was established that only a very limited part of the funds had gone to Church expansion or even to the much more broadly defined "Church-related" activities. By far, the bulk of the operations conducted had been totally unrelated to the Church or charitable activity at all.

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In arguing that the Company in the years in question was a charitable organization whose income was exempt from tax, counsel for the appellant stated that the Board should accept the “charitable organization” designation of the Company based upon the application that had originally been made in 1958, the many years of proper filing of corporation tax returns and the nil assessments received throughout the years. He pointed out that the Company had assisted in the establishment of some 10 churches and two summer schools since incorporation.

Counsel for the respondent alleged that the Company activities had put it outside the parameters for the continued income sheltering accorded a charity.

Mr. Taylor, Commissioner of the Tax Review Board, after considering the evidence, found specifically that the directors of the Company had not acted improperly. With respect to the question of the investments, Mr. Taylor stated that he believed “that the simple acceptance by an organization of donations, bequests or funds from some of its supporters for deposit, and the investment by the organization of these monies for the precise purpose of earning investment income thereon for the organization would not disqualify that organization from a ‘non-taxable status’ to which it might otherwise be entitled”. In his view, the question to be decided was whether the appellant was entitled to the nontaxable status which it claimed in the years in question because it was “functioning as such”. As authority he cited the case of *Christian Homes for Children v. M.N.R.*, 66 DTC 736, 42 Tax A.B.C. 248 which had been referred to by counsel for the respondent. In that case, another decision of the Tax Review Board was referred to where it was said that “a charitable organization or institution is an organization created for the promotion of some public object of a charitable nature and functioning as such”.

Based on the evidence, Mr. Taylor was prepared to find that the Company was conducting a business in such a way that the activity could be distinguished from simple investment of Company funds for the purpose of earning income therefrom. He found that the activity was an adventure in the nature of trade and that the stocks, bonds and real estate took on the characteristics of inventory rather than investment. Indeed, he found that the corporation had been operated for the specific purpose of making a profit from a business and not merely for earning income on investments. In his conclusion, Mr. Taylor stated that it appeared to him that the Minister’s position was clearly supported by the “profit provisions” of Section 149(1)(1), the appellant had not established its claim to “non-taxable status” and the taxpayer’s application was dismissed.

It would appear that this case was decided on the facts and should not be taken as standing for the proposition that charities engaging in the purchase and sale of real estate or mortgages will be found to be carrying on business as opposed to making investments. In fact, Mr. Taylor specifically stated that making investments for the purpose of earning investment income for an organization would not disqualify that organization from a “non-taxable status” to which it might otherwise be entitled. In this case, the Tax Review Board specifically found that the charity was not functioning as such. Under the current definition of a “charitable organization” found in paragraph 149.1(1)(b) of the *Income Tax Act* a charitable

organization must devote all of its resources to charitable activities carried on by the organization, and a "charitable foundation" is defined in paragraph 149.1(1)(a) to mean a corporation or trust constituted and operated exclusively for charitable purposes. If on the facts an organization or foundation is found not to be devoting its resources to charitable activities, then it should not enjoy the status of a registered charity. However, investment activity alone should not disqualify it.

Renaissance International

The *Renaissance International* case was argued before the Federal Court of Appeal on November 16 and 17, 1982. The case was not argued on the issue of whether Renaissance International had engaged in political activities, but on the basis of whether the principles of natural justice and procedural fairness required that a hearing take place before the Minister sent a notice under Subsection 168(1) of the Income Tax Act deregistering the charity. The Federal Court of Appeal agreed that a hearing is necessary before a charity can be deregistered, allowed the appeal and set aside the notice revoking registration.

It is expected that this decision will, at least until the legislation is changed, require the Minister in all cases to hold a hearing before he deregisters a charity. There is, however, no guidance in the legislation or in the judgment in the *Renaissance International* case as to what form of hearing is required.

At the time of writing this column, an appeal had not been filed by the Minister of Revenue in this case. To date, the case of the *Manitoba Foundation for Canadian Studies* discussed in previous issues of *The Philanthropist* has not been heard.

Income Tax Act and Regulations

Subsection 230(4) of the *Income Tax Act* was amended by S.C. 1980-81-82, c. 102, S. 5 (1), effective 90 days after the Royal Assent dated June 22, 1982. Paragraph 230(4)(a) now provides that every person required by Section 230 to keep records and books of account shall retain the records and books of account referred to in this Section in respect of which a period is prescribed, together with supporting vouchers, for such period as is prescribed. Paragraph 230(4)(b) requires records and books of accounts, other than those required to be kept for a prescribed period, together with supporting vouchers, to be kept until the expiration of six years from the end of the last taxation year to which the records and books of account relate. Formerly, subsection 230(4) required such records and books of account to be retained until written permission for their disposal was obtained from the Minister.

Part LVIII of the Income Tax Regulations relating to the retention of books and records by taxpayers was added to the Regulations on September 23, 1982, effective September 20, 1982. By Regulation 5800 (1)(d), a registered charity is required to retain any record of the minutes of meetings of its executive and members, all documents and by-laws governing the charity and all records of any donations received by the charity that were subject to a direction by the donor that the property given be held by the charity for a period of not less than 10 years, for two years after the date on which the registration of the charity is revoked.

Further, by paragraph (e) of this Regulation, registered charities are required to retain all records and books of account that relate to the registered charity and the vouchers and accounts necessary to verify the information in its records and books of account for the same period. By paragraph (f) of the Regulation, a registered charity is required to retain duplicates of receipts for donations, other than donations for 10-year gifts, that are received by the registered charity for two years from the end of the last calendar year to which the receipts relate.

Customs Duty and Federal Sales Tax on Goods for the Disabled

Revenue Canada, Customs & Excise has published a very informative booklet outlining the application of duty and federal sales tax to goods for the disabled. It is available from your local Customs Office as publication ISBN O -662-52001-7, Department of Supply and Services, Catalogue No. Rv 31-16/1982.

Ontario Retail Sales Tax Changes

Ontario retail sales tax changes in May and June of 1982 cancelled a number of important exemptions and introduced new taxes on repair labour for moveable property and meals that will affect the cost of operations of many charitable and non-profit organizations. The following tax exemptions were cancelled:

- student and classroom supplies
- materials to construct schools, universities and hospitals
- capital works projects for municipalities, local service boards and volunteer groups
- "energy conservation" items such as thermal insulation, storm doors and windows, heat pumps, etc.
- personal hygiene and household cleaning products.

All prepared foods sold in snack bars, cafeterias, lunch bars, coffee wagons, vending machines etc. are now subject to the seven per cent tax. Tax relief is still provided for meals provided to patients in hospitals, residents of nursing homes or homes for the aged on a no-charge basis by registered charitable or benevolent organizations. There is also some relief for non-profit organizations operating summer camps for disadvantaged persons and day care centres for children.

Non-profit organizations can still operate fund-raising events such as bazaars and rummage sales without being required to collect the tax as long as total annual receipts for sales of taxable goods at such events do not exceed \$75,000.

Costs of operating a charitable or non-profit organization will increase because of the new tax on repair and installation labour for moveable goods such as automobiles, furniture, free-standing appliances, etc. Repair and installation on real property such as buildings, furnaces, central air conditioning or other equipment securely fastened in or on a building are still not subject to the tax.

Religious institutions can still buy and repair equipment for use in worship services and they can still recover the tax on goods used to construct or repair buildings, parking lots, etc. In this regard, the Province has developed a simple formula for those entitled to recover the tax on any project for which tax was paid in the past three years.