

# Recent Tax Developments

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## Income Tax Changes

On November 8, 1984, the Honourable Michael Wilson, Minister of Finance, presented his "Economic and Fiscal Statement" to the House of Commons. At that time, he indicated his intention to proceed (with some minor modifications) with the enactment of the draft legislation released by the Department of Finance on August 24, 1984. The relevant resolutions relating to charities in the accompanying Notice of Ways and Means Motion to Amend the Income Tax Act and Related Statutes (Notice of Ways and Means) were identical to the corresponding provisions in the Notice of Ways and Means Motion that was tabled in the House of Commons on June 18, 1984, preparatory to the draft legislation of August 24, 1984. In all likelihood, the legislation that is enacted will be almost identical to the draft legislation of that date. These provisions are generally effective for taxation years of registered charities commencing after 1983.

The provisions in the August 24, 1984 draft income tax amendments differed somewhat from the provisions contained in an earlier version of the draft legislation and related technical notes issued on April 25, 1984. The significant differences are:

First, the definition of "registered charity" has been changed for a branch, parish or other division of a charitable organization or charitable foundation to ensure that such a division of a charitable organization or charitable foundation is resident in Canada and is either created or established in Canada.

Second, the "disbursement quota" for a taxation year of a charitable foundation (as well as a charitable organization) was modified in respect of the amount that must be expended in a particular taxation year. The quota is based on the total amount of gifts for which a charitable donation receipt was issued in the immediately preceding taxation year. In computing this total, the gifts that will be excluded therefrom will now include a gift of capital received by way of bequest or inheritance. Previously the exclusion applied only to a gift received from the capital of a testamentary trust. Gifts from other registered charities will also now be excluded from the donation receipts total.

Finally, the other significant change is applicable only to a taxpayer who is indebted to a private foundation in respect of a "non-qualified investment", as that term is to be defined in the *Income Tax Act*. Originally, the amount of the benefit received by such a taxpayer was to be measured by reference to the lesser of:

- a) the prescribed rate as provided for in the Income Tax Regulations from time to time; and
- b) a transitional rule relating to a debt incurred prior to April 22, 1982 in which the rate per annum was equal to six per cent plus two per cent for each calendar year after 1982 and before the taxation year in question.

This provision was further modified in the August 24, 1984 draft legislation which provided that the interest rate could be determined by reference to what the rate would have been at the time the debt was incurred if the taxpayer and the charitable foundation had been dealing with each other at arm's length and the ordinary business of the foundation had been the lending of money. In such a situation, the taxpayer is liable for the interest that would have been payable using the applicable rate of interest reduced by any interest paid in the year or within 30 days thereafter.

### **Toll-Free Telephone Information Services**

On July 26 of this year, the then Minister of National Revenue, the Honourable Roy MacLaren announced the establishment of a toll-free Revenue Canada telephone information service for registered charities and Canadian amateur athletic associations. The telephone calls will be handled by experienced staff of the Charitable and Non-Profit Organizations Section of Revenue Canada, Taxation in Ottawa. The purpose of this toll-free direct service is to answer relatively quickly and efficiently, questions regarding registration guidelines, departmental policies and other administrative and legislative matters.

This bilingual service can be obtained by calling 1-800-267-2384 during normal office hours from 8:00 a.m. to 4:30 p.m., each weekday (except holidays).

### **Canada-U.S. Tax Convention**

In August of this year, the new Canada-U.S. Tax Convention was ratified. Some of the provisions contained therein came into force in the fall while the remainder of the provisions became effective January 1, 1985. Article XXI covers the tax treatment of exempt organizations including registered charities and the treatment of donations by Canadian residents to U.S. charities.

With two exceptions noted in paragraph 3 of Article XXI, a registered charity is exempt from U.S. tax. Furthermore, a registered charity that derives substantially all of its support from persons other than residents or citizens of the United States will be exempt from the U.S. excise tax imposed in respect of private foundations.

Gifts (that would otherwise not qualify under paragraph 110(1)(a) of the *Income Tax Act*) to a U.S. resident organization which is generally exempt from U.S. tax and which would qualify as a registered charity if it were created and resident in Canada will be treated as gifts to a registered charity. However, such gifts with one exception which is noted later, are only deductible to the extent that the aggregate of such gifts does not exceed 20 per cent of income from U.S. sources. Generally, this provision is similar to the relevant article in the former treaty between Canada and the United States. However, the present treaty provides that gifts to a college

or university where the taxpayer or a member of his/her family is, or has been, enrolled will not be subject to the 20-per-cent limitation.

***McBurney v. The Queen***

A recent case of interest is *McBurney v. The Queen*, 84 DTC 6494, Federal Court Trial Division, involving a taxpayer who paid amounts to three Christian religious schools during the 1976 and 1977 taxation years which were ultimately held to be valid charitable donations.

The taxpayer's four children all attended the three schools at times during the years in issue. Each of the schools was a registered charity which qualified as a charity not only on the basis that it contributed to the advancement of education, but also on the basis that it contributed to the advancement of religion. The Court found that each corporation, with the school it operated, was, in law, a religious charity and an educational charity simultaneously. Parents of children attending the schools were requested, and expected, to make financial contributions but no child had ever been turned away because of the financial hardship of the parents. The Minister disallowed the deductions claimed by the taxpayer on account of amounts paid to the schools as charitable donations, taking the position that the payments were on account of tuition fees. The taxpayer appealed to the Federal Court Trial Division. The issue to be decided was whether the donations to the three charities were wholly deductible as gifts to registered charities, or whether some portion of the payments was to be disallowed for not being a gift, but rather a tuition payment in consideration of the taxpayer's children's education.

The Federal Court Trial Division allowed the taxpayer's appeal and found that the payments were gifts to registered charities and not tuition fees since the charging of tuition fees entitles a school to bar the pupil from attending for failure to pay the fee or to demand and sue for the promised money. Three witnesses had testified, in the opinion of the Court credibly and clearly, to the effect that the three schools did not levy a tuition fee upon any parent whose children attended the schools. The conclusion was that the taxpayer's payments were made as much without consideration as are contributions to a parish church. The Court distinguished the case of *The Queen v. Zandstra*, [1974] 2 F.C. 254, 74 DTC 6416 where tuition fees of a fixed amount were levied by the charity. Muldoon, J. in distinguishing the *McBurney* case from *Zandstra* found that what the taxpayer received in the *McBurney* case was not quantifiable and was indistinguishable in nature and quality from what a parishioner-contributor receives from and through a parish church, especially if that parishioner-contributor's children attend the church. He concluded that the taxpayer's payments were made without consideration and were deductible gifts.

The *McBurney* case has been appealed to the Federal Court of Appeal. If the decision of the Federal Court Trial Division is upheld, it will be interesting to see if courts in subsequent cases broaden the concept of what may constitute a gift to a charity where some element of benefit is involved or whether the decision will be restricted to its facts.