Recent Tax Developments

MARY LOUISE DICKSON
McCarthy & McCarthy, Barristers and Solicitors, Toronto

LAURENCE C. MURRAY
Thorne Ernst & Whinney, Chartered Accountants, Toronto

White Paper Proposals Affecting Charitable Giving and Charities

On June 18, 1987 (16 years to the day after the last major tax reform initiative) the Minister of Finance, the Honourable Michael Wilson, released the government's proposals for tax reform. The immediate effect of these proposals, which are effective January 1, 1988, is that the deduction for charitable donations at present provided in the *Income Tax Act* will be replaced by a two-tier tax credit system for individuals. There will be no changes to the tax treatment of registered charities themselves nor to the deduction allowed to corporations on account of their charitable donations.

Effective for 1988 and subsequent taxation years, an individual will be allowed a 17-per-cent federal tax credit on the first $250 of gifts made in the year and 29 per cent of the balance; this credit can be used to reduce the federal taxes that would otherwise be payable. The 17 per cent and 29 percent correspond to the lowest and highest tax brackets applicable to individuals. The proposed federal marginal tax rates are as follows:

Taxable income up to $27,500	17%
Taxable income from $27,501 to $55,000	26%
Taxable income greater than $55,000	29%

Because of the two-tier credit system, those taxpayers in the middle- and upper-income marginal tax brackets would be worse off with regard to the first $250 of donations under the tax credit scheme in comparison to the tax deduction method in force at present. Individuals who are in the two lowest tax brackets but who contribute more that $250 annually to registered charities, will be treated more favourably under the proposed system.

The general rule applicable to the maximum charitable donations allowable for income tax purposes in any particular year, i.e., 20 per cent of a taxpayer's net income (with certain exceptions), will not be changed. However, any excess charitable contributions can be carried forward for up to five years. The proposed credit system will be applicable to charitable donations carried over from 1987 and preceding taxation years.

Assuming that the applicable provincial rate is approximately 50 per cent of the federal income tax rate, the tax rate in the highest tax bracket would be approximately 44 per cent whereas under the present provisions, it is approx-

imately 51 per cent. As a result of the lowering of the tax rates, the after-tax cost of giving to a registered charity will be increased for both individual and corporate donors.

***Alberta Institute on Mental Retardation* v. *The Queen*, 87 D.T.C. 5306— Federal Court of Appeal.**

In *Alberta Institute on Mental Retardation* v. *The Queen* the Federal Court of Appeal (split 2 to 1) held (surprisingly) that any business carried on by a charity can be a related business as long as the profits are spent on charitable activities and the profits are not too substantial. "Too substantial" is not defined.

The facts were, that the appellant was created by the Alberta Association for the Mentally Handicapped (the "Association") to serve as a fund-raising vehicle for various registered charities carrying on programs for the benefit of people suffering from mental retardation. It was planned that the appellant would solicit and collect used household items and sell them at wholesale to an arm's-length profit-making entity called Value Village Stores Ltd. ("Value Village") for a guaranteed minimum amount plus 50 per cent of retail sales in excess of that amount. An agreement between the appellant and the Association provided that all of the funds received by the appellant from Value Village would be forwarded to the Association for its use in charitable projects.

The Minister of National Revenue refused to register the appellant as a charity on the basis that it was a public foundation that was not operating exclusively for charitable purposes and that was carrying on a business other than a "related business" as defined in the *Income Tax Act.* (Under the *Income Tax Act,* a charity categorized as a public foundation must operate exclusively for charitable purposes and is not entitled to carry on a business other than a "related business". A related business is defined in paragraph 149.1(1)(j) to include a business that is unrelated to the objects of the charity if substantially all of the people employed by the charity in the carrying on of that business are not remunerated for such employment.)

Until this judgment, most tax practitioners thought that a registered charitable organization or public foundation could carry on a business whose purposes were related to the charitable activities carried on by the charity, or an unrelated business as long as such unrelated business was staffed by volunteers, but could not carry on a business which was not related to its activities if it was not staffed by volunteers. The majority of the Court did not agree and found that a charitable organization or public foundation may carry on an unrelated business that is not staffed by volunteers as long as it spends the profits on charitable activities and the profits are not "too substantial".

An important factor in the decision appears to have been that when the provisions of the *Income Tax Act* relating to business activities were being considered in Committee in the House of Commons, the Minister gave, as an example of a related business, the operation of a cafeteria on the premises of

an art gallery or hospital. The judge thought that since such activities could be operated by concessionaires for profit, then an activity of the type engaged in by the appellant must be in the same category. In his view, such an interpretation is consistent with the clear intention of Parliament to recognize the contemporary reality in so far as the fund-raising activities of modern charitable organizations are concerned.

This decision will no doubt be welcomed by charities as it broadens the scope for charities to raise funds by engaging in commercial activities that bear no relation to the particular charitable endeavours of the charity. The only problem is that the Federal Court will allow such unrelated activities to be a related business only if the profits are not "too substantial" and the business not "too commercial". Since the objective of most charitable organizations is to raise as much money as possible, the restriction on being successful poses a dilemma.