Recent Tax Developments

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

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

Tax Reform

The Notice of Ways and Means Motion to Amend the *Income Tax Act* which was introduced in the House of Commons June 13, 1988 contained the legislative changes required to convert the tax deduction formerly available for charitable donations to a two-tier tax credit with a tax credit of 17 per cent on the first $250 of charitable donations and 29 per cent on the balance of such donations. Assuming a provincial tax rate of 50 per cent, the credit is equal to 25 per cent in the case of donations of $250 or less and 44 per cent on the balance. Obviously, the after-tax costs of the donations will increase under the tax reform proposals but such costs are not due to the conversion from the deduction to a credit (with the exception of the first $250 of charitable donations), but rather to the lowering of the marginal tax rates in Canada.

While most of the provinces in Canada will convert from a tax deduction to a tax credit with respect to charitable donations, the Quebec Finance Minister has indicated in his annual budget that Quebec will maintain a tax deduction for donations rather than a tax credit in order to simplify the administration of the *Income Tax Act*. Accordingly, the after-tax costs of the charitable donation will relate directly to the marginal tax rate of the individual donor.

These new provisions only apply to individuals; there have been no changes to the tax treatment of donations by corporations, although the provisions relating to donations by corporations will be set out in a separate section of the *Income Tax Act* and not in the existing section, which applies to all taxpayers, as the latter provision will be repealed.

Tax Cases Affecting Charities

There have been a number of cases of interest to charities in the past few months: two concerned donations to charities and two concerned applications for registration.

Decision Reversed

In *The Queen* v. *Burns*, 88 DTC 6101, the Federal Court—Trial Division reversed the Tax Court of Canada decision (83 DTC 557) and held that payments made by the taxpayer in 1977, 1978 and 1979 to the Canadian Ski Association when his daughter was a member of the training squad of one of its divisions, were not true gifts and thus were not deductible from the income of the taxpayer in those years. Many in the charitable community questioned the original finding of the Tax Court that the gifts should be deductible for income tax purposes and will not be surprised that the decision has been reversed.

It was mainly a decision on the facts and the meaning of the word "gift". The evidence clearly showed that the taxpayer knew that when his daughter became a member of the training squad he would be required to make payments to the Association. Further, when his daughter was injured in 1979, the taxpayer stopped paying. Finally the taxpayer spontaneously agreed that he would not have paid the fees he did pay if his daughter had not been part of the training squad.

The judge emphasized that one essential element of a gift is an intentional element identified in Roman law as "liberal intent". Donors must be aware that they will not receive any compensation other than pure moral benefit; they must be willing to "grow poor" for the benefit of their donees without receiving any compensation. He found on the facts that the securing of the development and training the taxpayer desired for his daughter and the making of the payments at issue in the appeal went hand in hand. The defendant taxpayer believed he was paying for his daughter's ski training and considered that to be the benefit, therefore he did not have the liberal intent required for the payments to be characterized as gifts.

In this case the judge referred to the Federal Court of Appeal decision in *The Queen* v. *McBurney*, 85 DTC 5433, where the Court made it clear that parental financial contributions, made in lieu of tuition fees, to private schools attended by their children, were not gifts. The *Burns* decision should put to rest any hopes parents had of deducting payments made in respect of their children's extra-curricular activities as charitable donations or donations to an amateur athletic association, unless of course, it is absolutely clear that the donations are entirely voluntary and bear no relation to their children's activities.

Donations As Business Expenses

In *Impenco Ltd.—Impenco Ltée* v. *M.N.R.*, 88 DTC 1242, Tax Court of Canada, the issue was whether the taxpayer, who manufactured boxes for jewellery, watches and gift items, could claim contributions to various charitable organizations as business expenses. The taxpayer in this case did not make any claims for donations to charities, but claimed all amounts it spent in support of charities as business expenses. The Tax Court allowed the taxpayer to

deduct the expenses as a cost of doing business. It found that the outlays were not gifts but were made for the purpose of earning income.

In the past many businesses have claimed donations made to charities as business expenses rather than charitable donations but this is the first case of which we are aware where a court has supported such donations as a proper expense of doing business. In this particular case, the taxpayer was able to prove that the donations attracted customers it might otherwise not have had. It will lend support to those taxpayers who wish to claim certain of their donations as business expenses rather than charitable donations. One advantage of claiming the donations as business expenses is that they are not subject to the 20-per-cent-of-income maximum that may be donated to charity by a taxpayer in a particular year.

Registrations Denied

Two other unconnected cases concern applications to register charities. In both cases the Federal Court of Appeal explored the meaning of "charity" in connection with socially commendable activities in the context of modern society, and in both cases denied the applicant's request to be registered as a charity for income tax purposes.

In *Positive Action Against Pornography* v. *M.N.R.*, 88 DTC 6186, the appellant was incorporated under the *Societies Act of Alberta* for the purpose of providing educational material to the community regarding the issue of pornography. The Minister of National Revenue rejected an application made by the appellant for registration as a charity on the basis that the primary purpose of the appellant was not to educate in the charitable sense, but to achieve social change by swaying public opinion in support of minimizing and possibly eliminating pornography from society.

In *Toronto Volgograd Committee* v. *M.N.R.*, 88 DTC 6192, the appellant was an unincorporated association. Its members were "deepy concerned about world tensions, including the threat of a nuclear holocaust" and its objects included the re-creation of the link between residents of Toronto and Volgograd first established in 1942–1943, the creation of a people-to-people relationship, and enhancement of the relationship through exchange visits. It arranged exchange visits between Toronto and Volgograd residents and promoted understanding between the citizens of the two cities by seeking media coverage and through speaking engagements. The Minister of National Revenue rejected the appellant's application for registration as a charity on the grounds that the appellant could not qualify "under the advancement of education or as a purpose beneficial to the community as a whole in a way which the law regards as charitable".

Both appellants appealed the denial of registration to the Federal Court of Appeal arguing that their activities were directed towards the advancement of education and their purposes were beneficial to the community in a charitable

sense. Both courts found the activities of the appellants were not charitable in the legal sense. They held that the primary purposes or activities of each appellant were not beneficial to the community in a way the law regards as charitable but rather were primarily political.

Both Marceau J. and Mahoney J. wrote separate judgments in *Toronto Volgograd* but reached the same conclusion as Stone J. Marceau J. pointed out that the *Income Tax Act* definition of a charitable foundation and a charitable organization distinguishes between the passive and the active in that a charitable foundation's purposes must be charitable while the law is clear that political activities traditionally are not charitable. The judges found the activities of both *Positive Action* and *Toronto Volgograd* to be primarily political rather than charitable.

The *Positive Action* and *Toronto Volgograd* cases are important because they indicate the thinking of four judges of the Federal Court of Appeal on the issue of politics and charities. With the addition of these two cases, only five cases on the subject of charity have been heard by the Federal Court of Appeal. (The others are *Scarborough Community Legal Services* v. *The Queen*, [1985] 2 F.C. 555; *Native Communications Society of B.C.* v. *M.N.R.*, [1986] 3 F.C. 471; and *Alberta Institute on Mental Retardation and Canada*, [1987] 3 F.C. 286.) Decisions in the *Scarborough Community Legal Services* case, the *Alberta Institute on Mental Retardation and Canada* and the *Native Communications Society of B.C.* cases indicate the Court is prepared to take a lenient view where registered charities engage in activities that are not strictly charitable. *Positive Action* and *Volgograd*, however, indicate the Court is taking a more stringent view of charitable activities where the particular organization is not yet registered.