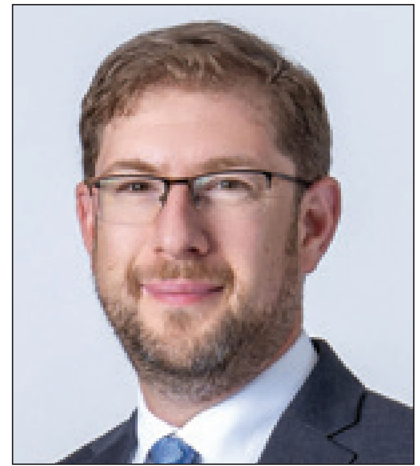
CHARITABLE DONATIONS

A Summary of Tax Considerations



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INTRODUCTION

It is a peculiar result of history that regulation of charities in Canada is part of the *Income Tax Act (ITA)*. One of the unintended consequences of this placement is that the regulation of charities fits primarily within an income tax context. So, donations are incentivized using income tax mechanisms and sanction against charities is framed as the revocation of the special status that provides charities with their umbrella of privileges. This means that both charities and their supporters cannot fully understand their options for supporting a particular charitable aim without understanding the incentives of donating to charity and the limitations in charitable operations.

QUALIFIED DONEES

It bears mentioning that government has extended the benefits given to charities to certain other entities known as qualified donees. They include:

- Registered Canadian amateur athletic associations;
- Certain organizations that provide low-cost housing for the aged;
- Most municipalities;
- Certain municipal or public bodies performing a function of government in Canada;
- Registered national arts service organizations;
- Certain foreign charities that have received a gift from the federal government;
- The federal and provincial governments;
- The United Nations and its agencies; and,
- Registered journalism organizations.

INCENTIVES

As the incentives for donating are primarily tax-based, one should have a basic understanding of the tax system to appreciate the value of the inducement. There are two fundamental aspects of Canada's tax system to keep in mind. The first is that Canadians are taxed progressively. That is, the first chunk of income (a bracket) is taxed at a low percentage, the next chunk at a higher rate and so on. The second rule to understand is that – after a Canadian adds up their entire income – there are certain subtractions that are made that reduce the total amount of tax that is paid to the government.

Those that are made prior to the application of the tax rate are called deductions; those that are made after are called credits.

Tax donations are treated as either donations or credits depending upon who makes the donation. If the donations are made by corporations, the donor entity can deduct the amount of the donation from its income prior to the application of the appropriate tax rate(s) to its income bracket(s). On the other hand, when donations are made by individuals, the amount of the donation is multiplied by the appropriate federal percentage and deducted from federal tax and the same procedure is conducted in each province at their rates. The product of these calculations is then deducted from the tax owing.

The tax credit itself is determined by multiplying the first $200 by the lowest combined federal/provincial rate in the appropriate province (except Alberta) and multiplying everything over $200 by the designated rate (in most Canadian jurisdictions the highest provincial rate (and federally it is either the highest (33%) or second-highest (29%) depending on the circumstances of the donor). The table on the next page (Table A, page 11) illustrates the tax credits available for donations of $1,200 in the different provinces.

As most Canadians are not subject to Alternative Minimum Tax, the discussion below assumes the more typical taxing situation. And, to simplify the discussion, we will make two assumptions. First, unless otherwise stated, the donor holds the items to be donated as capital property. Second, we will assume a credit rate of 46 per cent.

DONATIONS OF CASH

Donations of cash are straightforward. The charity simply receipts the face value of the amount donated. (This

does not apply to currency held for collection purposes). Depending on the province and the donor's tax bracket,the tax credits generated from the donation would offset the tax owing on the income earned, so no tax would be payable on the money earned and then donated. At lower income brackets, and in Alberta, the credits would actually be more than offset by the tax owing and the donor would be able to shelter other income from tax with the credits earned from this donation. If the donor is donating cash that is not income to them in the year donating, the credit could be used to offset taxes owing from other sources. But, in those provinces where the tax rate is higher than the credit rate on donations, the donor could still be paying tax on a dollar given to charity!

PUBLIC SECURITIES

Canada levies tax on the appreciation in value of a capital good. The tax is levied when the item is disposed of (i.e. sold, given away, or donated).

However, the *ITA* does contain an exemption for publicly listed securities (on certain exchanges) donated to charity.

Moreover, the donor continues to receive a donation tax receipt equal to the fair market value of the shares donated. Thus, there is no tax on the donation, but the donor still receives a tax credit equal to the fair market value of the donation.

While shares of publicly traded corporations are the most popular form of security to be donated to charity, there are a variety of other sophisticated financial securities that may also be donated.

Examples include exchange-traded funds, index funds, hedge funds, warrants, rights, and put and call options. If these products qualify as publicly traded securities, they will qualify for the special tax treatment accorded donations of this type.

Example:

Assume that Kirk lives in Ontario and buys one share of a high-tech company for one dollar ($1). Over time, the share rises in value and may even split once or more than once. After ten years, with all splits factored in, Kirk owns shares worth a total of $100. If Kirk were to sell the share, he would have a capital gain of $99 (i.e. the fair market value of $100, less the cost of $1). Applying a capital gains inclusion rate of 50% (as opposed to 66% if the gain were greater than $250,000), only $47.50 would be taxable. Further applying a tax rate of 46%, the amount of tax payable would be $21.85. Thus, if Kirk sells the shares, he is left with after-tax income of $78.15 (i.e. $100 - $21.85).

Conversely, let's say Kirk decides he wants to donate his shares instead of selling them. In this case, Kirk has no tax to pay and, of course, receives no income from the sale of the share. He does however receive a tax receipt for $100, which (ignoring the lower credit rate for the first $200) will offset $46 of taxes due from other sources. So, assuming Kirk is paying tax on income from other sources, the actual after-tax cost of this donation is $54.

FLOW-THROUGH SHARES

For income tax purposes, the cost of a flow-through share is deemed to be zero. So, even if the buyer buys the share at $10.00 and sells it at $8.00, the share is still assumed to have gained $8.00 in value and is therefore taxed on an $8.00 capital gain even though it actually lost $2.00. (Don't worry about the share- holder though; ownership of the share gave them access to a deduction making it worthwhile). Flow-through shares are like any other asset and can be donated to charity. When these shares are publicly traded, there is no tax on the capital gain. However, for purposes of donation, the law considers the amount of the purchase price to be a capital gain and only the amount in excess of that (if there is any) to be eligible for the capital gains exemption.

STOCK OPTIONS

An employee who exercises a stock option (i.e. buys it at less than fair market value) receives a benefit equal to the difference between the purchase price (and any amounts they may have paid for the option) and the fair market value at the time of purchase. Tax is calculated based on the amount of this benefit which is added into income. Depending on overall income and capital gains, the

Province	Combined Federal / Provincial Tax Credit Rate on first $200 donation	Tax Credit	Combined Federal / Provincial Tax Credit Rate on amounts over $200[2]	Tax Credit on amount over $200	Total combined Federal and Provincial Tax Credit
Alberta[3]	75.00%	$150.00	50.00%	$500.00	$650.00
British Columbia	20.06%	$40.12	45.80%	$458.00	$498.12
Manitoba	25.80%	$51.60	46.40%	$464.00	$515.60
New Brunswick	24.40%	$48.80	46.95%	$469.50	$518.30
Newfoundland	23.70%	$47.40	50.80%	$508.00	$555.40
Northwest Territories	20.90%	$41.80	43.05%	$430.50	$472.30
Nova Scotia	23.79%	$47.58	50.00%	$500.00	$547.58
Nunavut	19.00%	$38.00	40.50%	$405.00	$443.00
Ontario[4]	20.05%	$40.10	40.16%	$401.60	$441.70
Prince Edward Island[5]	24.80%	$49.60	45.70%	$457.00	$506.60
Saskatchewan	25.50%	$51.00	43.50%	$435.00	$486.00
Yukon	21.40%	$42.80	41.80%	$418.00	$460.80

Table A - ***Tax Credit on $1,200 in donations for 2024***

employee can claim a deduction against the stock option benefit so only 50% of the benefit is taxable up to $250,000 and after that only 33%. If an employee stock option is exercised and marketable securities are donated within 30 days after the option is exercised, and if certain other conditions are met, only 25% of the benefit is taxable. If the shares are traded on a public exchange, then their donation is treated as the donation of other publicly listed shares as described previously.

PRIVATE SECURITIES

The donation of securities of private corporations is dealt with in one of two ways; either the gifts are "excepted" or they are not. An excepted gift is a share donated to a charitable organization or public foundation where the donor deals at arm's length with the charity's directors/trustees, officers and other like officials. In these circumstances the gift is treated as any other gift of capital in which there is no special tax treatment for the donation (i.e. the donor pays tax on the disposition).

In cases where the gift has been donated to a private foundation or to a public charity to which the donor is related, the gift is not considered "made" until one of two things happen: either the item donated must cease to be a non-qualifying security (e.g. the corporation is no longer controlled by the donor or the corporation becomes publicly listed) or the charity has disposed of the security within five years of receiving the donation. The fair market value of the gift is then the lesser of:

- the value of the security when transferred to the charity,
- and the value of the security when the gift is deemed to have been made.

Note that the donor does not have to include any capital gain in their income before the shares are sold by the charity, so that the donor is not paying tax in advance of receiving the receipt. If the charity does not sell the shares within five years, the donor will not receive a receipt and the gain will never be taxable.

RRSPs/RRIFs

People may find that they have more than enough money in their RRSPs once they get to a certain age and are willing to make donations in their lifetime to see the fruits of those donations while they are still alive. The RRSP rules do allow for withdrawals from the plan but, upon withdrawal, the institution that holds the account (usually a bank) is required to withhold certain amounts. These amounts on a per withdrawal basis (i.e., not cumulatively for the year) are:

- 10% (5% in Québec) on withdrawals up to $5,000;
- 20% (10% in Québec) on withdrawals between $5,001 and $15,000; and,
- 30% (15% in Québec) on withdrawals of more than $15,000.

The amounts withdrawn are claimed as income to the owner of the RRSP in the year withdrawn and tax is paid at the owner's marginal rate. Thus, if a potential donor wants to donate $50,000 and has that money in his or her RRSP, a withdrawal of $50,000 would give the potential donor outside of Québec $35,000 cash to donate. The remaining 30 per cent ($15,000 in this case) would be remitted to the government by the bank and credited as income tax already paid when the donor files his or her tax return for that year.

A donor may also wish to donate his or her RRSP or RRIF upon death. There are two ways to do this. One way is to list the charity as a beneficiary of the RRSP in the donor's Will. The other way is to make use of the direct beneficiary election, which is signed when the RRSP is first opened (and can usually be changed at will). If the first method is used, the RRSP will fall into the donor's general estate before passing on to the charity. Under the second method, the RRSP will automatically become the property of the charity without going through the estate.

The advantage of using the RRSP direct beneficiary election is that the RRSP will not pass through probate. When a Will is probated, the various provinces charge different amounts of tax on the total value of assets passed on in the Will. Thus, the amount of money in an RRSP is added to the other assets and a portion is taken by the government before any of the assets are passed on.

INSURANCE

Sometimes an insurance policy becomes superfluous. If the policy is unnecessary, the donor may decide to donate it to charity.

From a tax perspective, the donor of a life insurance policy will have an income inclusion of the proceeds of disposition less the adjusted cost base (ACB). An income inclusion is distinct from a capital gain and effectively means that a donation of an insurance policy has no net tax benefit for the donor. The ACB calculation is rather complicated and considers the premiums paid, dividends received, and – for policies purchased after 1982 – the Net Cost of Pure Insurance (NCPI). Despite the ominous name, the NCPI is not overly difficult to calculate, although it will likely require professional advice from either an experienced advisor or the insurance company involved.

In a February 2008 bulletin— and later in another setting — the Canada Revenue Agency (CRA) laid down certain guidelines for determining the Fair Market Value of a disposed-of policy. In these pronouncements, the calculation of the proceeds of disposition (POD) of an insurance policy considers:

- the policy's loan value;
- the face value of the policy;
- the state of health of the insured and their life expectancy;
- conversion privileges;
- other policy terms, such as term riders, double indemnity provisions; and,
- replacement value.

The idea here is that the value of a policy may or may not be accurately reflected by any cash surrender value held by the policy. When valuing the policy for both tax and receipting purposes, the donor and the charity must take into account the fact that the donor may be very ill and the policy may mature shortly after donation. A policy that would otherwise be impossible to receipt would become valuable to the donor. To do this, the advice of

an actuary and an appraiser is critical to correctly valuing the policy. The charity may either cash the policy and use the funds immediately or pay the premiums on the policy and collect the larger death benefit when the insured dies. Of course, a very generous donor may not only donate the policy to the charity but also donate the yearly premiums to the charity. In this case, both the donation of the policy and the donated premiums would be receiptable.

ANNUITIES

An annuity is a contract under which one person deposits a sum of money with another in exchange for a subsequent income. It is basically the reverse concept of insurance.

The income may be paid for either a specified period, for life, or for life with a minimum guaranteed period. Under the latter method, if the purchaser of the annuity dies during the guaranteed period, the annuity will be paid to some other person whom the purchaser had designated to receive it.

Although annuities are normally purchased from insurance companies or trust companies, life annuities are sometimes purchased from charities.

Essentially, a person gives the charity a sum of money irrevocably in exchange for a promise by the charity to pay the donor a monthly income for life. The funds received would then be invested by the charity at a higher rate than it would pay to the donor.

For annuities issued after December 21, 2002, the donor would be eligible to receive a receipt for an amount equal to the excess of the amount contributed by the donor over the amount that would be paid at that time to an arm's-length third party to acquire an annuity to fund the guaranteed payments.

CANADIAN CULTURAL PROPERTY

The Government of Canada has set up the Canadian Cultural Property Export Review Board to certify which artwork or other item has cultural significance to Canadians. This not only applies to works with a Canadian aspect, but it also applies to any cultural work that Canada may want to keep within its borders. If the donation is certified and made to a designated institution, there is no tax due on the disposition. Thus, if the charity is hoping to attract donations of property with a particular cultural significance, it is important to secure the designation.

There are two categories of designation:

- Category A is granted for an indefinite period to institutions that are well-established and meet all of the criteria related to certain legal, curatorial and environmental requirements.
- Category B is granted in relation to an institution involved in the proposed acquisition of an object (or collection) that does not meet all of the criteria for designation, but which has demonstrated its capability to effectively preserve the type of property in question.

The criteria by which the review board makes its decisions is beyond the scope of this article, but the board has published a guide on the subject available on their website. More information on the program is available from the Department of Canadian Heritage on its website at https://www.canada.ca/en/services/culture/history-heritage/movable-cultural-property.html:

As a proper certification may involve many months of research, a request for certification should be made well before the donation is contemplated.

If a taxpayer donates certified property to a designated institution, there will not be any tax owing on the gift. In addition, the taxpayer is entitled to a tax receipt for 100% of the value of the gift (as determined by the review board).

INVENTORY

The determination of whether an item is inventory or capital is one of the most fundamental areas of our income tax system, but nevertheless is shrouded in vagueness and controversy. For example, to most people a house is a capital property. But if the owner of the home is engaged in the business of buying and selling homes, the property becomes inventory of a business. There is a different tax treatment on the disposition of inventory as 100% of the value is included in income (as opposed to capital, of which only 50% or 66% is included).

Nonetheless, the donation of inventory will result in tax credits that will at least offset the tax due on the disposition of the inventory.

Example:

Spock runs a bakery. His business is not incorporated, so all of the income of the business is taxed at his personal rates during the year. After Spock has deducted all of his expenses, he is left with taxable income in the year of $50,000. If Spock sells one more cake that is worth $100, he will pay tax at his bracket on that cake of, say, $31.

However, upon donating the cake, he will be entitled to tax credits of approximately $40 (assuming that he has already made at least $200 worth of donations). This is because the tax credit rate is higher than the tax payable rate. Spock can then offset the tax owed by disposing of the last cake and using the additional $9 against the tax owing on his other $50,000 of income. It's all very logical!

Of course, as income grows, so too does the tax rate, meaning that there are fewer leftover credits. In those provinces where the tax is equal to or greater than the credits generated by donation (which is all provinces except Alberta), there would be no additional tax credits left over for use. In Alberta however, the credits will always more than offset the tax on the disposition of the donated item, even at the highest brackets. Given the number of provinces, the multiplicity of tax rates and brackets, and the frequency with which they change, an accountant should be retained to calculate the results of any donation of inventory.

PERSONAL USE PROPERTY

Personal Use Property (PUP) is property that is owned by the taxpayer and that is primarily for the personal use and enjoyment of the taxpayer or persons related to the taxpayer.

PUP includes:

- Bottles of wine
- Loyalty points programs
- Air Miles
- Shoppers Optimum points
- Religious items
- Gift certificates
- Clothes
- Artwork
- Hobby items
- Comic books
- Model trains
- Toys
- Land (e.g. a fishing hole)
- Books

Normally, when these types of items are donated to a charity, the charity does not issue a receipt, nor does the owner expect one. This is, in most cases, the appropriate treatment. However, technically it does not have to be so.

The *ITA* specifies that for donations of PUP, the minimum cost is deemed to be $1,000. This is true regardless of the actual cost to the owner. The *ITA* also deems the item sold for a minimum of $1,000, again regardless of the actual sale/donation value. So, when taken into the donor's tax return, there is no taxable event on items that are worth less than $1,000.

On the other hand, a tax receipt can still be issued for these types of items. The value on the receipt would reflect the item's fair market value. This receipt could then be used to generate some tax credits on the return (small though they may be). Charities should note, however, that valuing household items can be very difficult, and receipts should only be issued if value can be defensibly determined.

Example 1

Sulu bought a "Tickle Me Elmo" doll for $20. Shortly thereafter, it became a collector's item and the fair market value increased to $100. Realizing that there are needy children without a Tickle Me Elmo, Sulu donates the toy to a local charity. In return, he receives a tax receipt for the value of $100. On his tax return Sulu calculates his capital gain as follows:

Deemed Proceeds of Disposition	$1,000
Deemed Cost	-$1,000
Capital Gain	0

As there is no capital gain, there is no tax payable. On the other hand, Sulu will receive a tax receipt for the fair market value of the doll ($100). Applying our assumptions (i.e. a tax rate of 46% and Sulu has already made at least $200 of donations), the $100 receipt will allow Sulu to claim back $46 of taxes owing from other sources.

The implication of this policy is that when items are donated which have an actual value greater than $1,000 but a cost lower than $1,000, the value of the donation will be enhanced because the amount of the capital gain will be reduced.

Example 2

McCoy decides to donate a model train set that he purchased for $100, but has it appraised in advance and discovers to his delight that it is actually worth $2,000.

McCoy still decides to donate the train set to a willing charity, which issues him a receipt for $2,000. He then calculates his taxes as follows:

Actual Proceeds of Disposition	$2,000
Deemed Cost	$1,000
Capital Gain	$1,000
Tax	$230
Tax Credits	$920
Total leftover credits	$690

There are three notes to make about the type of property donated.

First, make sure that the property is actually transferable. While loyalty program points are property, some plans will not allow you to transfer the points to anyone else, and so they effectively cannot be donated. In this scenario, a donor may consider redeeming the points and then donating the actual item. Of course, this may prove to be of limited assistance to a charity that suddenly finds itself obligated to use a plane ticket to some place it did not want to go on a date it did not want to travel.

Second, both the individual and the charity must obtain a reliable valuation. From the perspective of the individual, an improper valuation could lead to a donation tax credit being disallowed by the CRA. The charity, on the other hand, has an obligation to issue proper receipts. So, if the receipts are overvalued, the charity may find itself facing uncomfortable questions from the CRA. And the donor a difficult fight about their tax receipt.

Finally, there are rules in the *ITA* which prevent situations where donors are buying and donating items that fall below the $1000 threshold simply to create tax receipts to shelter income from other sources. While the charity will not necessarily be punished if involved in such a scenario, the donor could have the receipts disallowed.

LISTED PERSONAL PROPERTY

Listed Personal Property (LPP) is a subclass of PUP. It consists of certain specific items which are held both as an investment and as hobby items. The list includes artwork, stamps, books, coins and sculptures. Unless it is Certified Canadian Cultural Property (see earlier in this article), LPP has the same tax treatment as PUP.

REAL ESTATE

Generally, the donation of most real estate will be treated like the donation of any other type of capital property. If the item is inventory, the donor will be taxed on the full proceeds of disposition, and, if the item is capital, the donor will only pay tax on 50% of the proceeds of disposition. There are, however, two significant exceptions to this rule.

Principal residence

The first exception is the donation of a principal residence. Canadian residents are not taxed on the gain arising from the appreciation of their principal residence. So, if a donor bought his home for $100,000 and sells (or donates) it when it is worth $1,000,000, no tax will be payable on the appreciation in value (assuming the home was the donor's principal residence for that entire time).

If the donor were to donate the home to a charity, not only would there be no tax consequences on the disposition, but he

or she would receive a tax receipt equal to the fair market value of the home at the time of the donation.

In some cases, it might make sense for the donor to leave their home to a charity in their Will. By doing this, they might be able to use the tax credits from the donation to offset the income from the deemed disposition of their other assets and carry back the credits to the previous year. In both the year of death and the year preceding death, the estate can use the tax credits to offset up to 100 per cent of the income. Given that the deemed disposition of assets (except for the principal residence) usually results in a large income in the year of death, the donor might, in fact, be able to do some significant tax planning in this way.

Environmental property

The donation of environmental property has a treatment similar to that of Certified Cultural Property. The treatment applies where property is designated as ecologically sensitive land by the Minister of the Environment (or a person designated by the Minister) and donated to any of:

- The federal or a provincial government;
- A municipality in Canada;
- A municipal or public body performing a function of government in Canada; or,
- A registered charity that has a main purpose (in the opinion of that Minister) of conserving and protecting Canada's environmental heritage, and that is approved by that Minister or that person in respect of the gift.

In any of these cases, there will be no taxable capital gain on the donation.

We have described the specific tax treatment of items donated where there is no tax on the capital gain of the item in the sections on public securities and certified cultural property. The only significant difference is that tax credits generated from a donation of this type may be carried forward for ten years. The entire value of the donation is available to offset tax owing from other sources at the highest rates.

RESIDUAL INTERESTS

It is possible to divide ownership of the property during one's life (called a life interest) from ownership upon the death of that person (called a residual interest). Once the residual interest is sold or given away, however, the property will belong to the owner of the residual interest when the owner of the life interest dies. A donor might consider this course of action in situations where they want to enjoy the income or use of the property during their lifetime and yet donate the property to the charity during their lifetime as opposed to on their death.

The value of the residual interest is calculated using an estimated value of the underlying property at the expected death of the donor (in itself determined from actuarial mortality tables) using present value dollars. This amount will be the value listed on the charity's donation receipt.

Determining the fair market value of a property at the expected death of the owner at some point in the future is a complicated mathematical task best left to a qualified actuary and appraiser.

From a tax perspective, when the owner divides the rights and donates the residual interest, the donor would generally incur a tax consequence. The tax owing will be a function of the cost of the right to the owner and its estimated value at the time of disposition. Generally speaking, this income will be treated as a capital gain. The capital gain is calculated according to a specific formula and depends on the gain in value of the residual interest relative to the entire property.

CHARITABLE REMAINDER TRUST

A trust is a legal device which effectively accomplishes one or both of the following objectives:

- It separates the ownership of property (the capital interest) from the right to receive income from the property (the income interest); and,
- It can separate the person who legally controls the property from those entitled to benefit from it.

A Charitable Remainder Trust (CRT) is similar to the donation of a residual interest in that it allows the donor to donate the capital of the trust now, but the charity does not receive it until some later point (such as on the death of the donor). A CRT is particularly useful in situations where it is difficult to record the division of interests on title (such as artwork). Despite its legal potency, creating a CRT is simply a matter of signing the appropriate legal documents.

When a donor creates a CRT, they dispose of the residual interest in the property to the trust and then donates the certain rights in the trust to the charity (the "capital interest"). It is important to note that the donation in this case occurs when the owner transfers the interest in the trust to the charity. Thus, if the underlying property is, for example, publicly-traded securities, the gift of an interest in the trust will not attract the same favourable tax treatment as donating the securities would have; it is a donation of an interest in a trust, not of securities.

The special tax treatment assigned to different types of property outlined elsewhere in this chapter (i.e. ecological property, publicly-traded securities, or certified cultural property) likely makes them inappropriate candidates for this type of donation.

It is important not to create the trust with the charity as the beneficiary, because if the donor is not careful, they will gift an interest in the trust with no property (and thus no value on the receipt), and any subsequent disposition to the trust will not be considered a gift by the CRA. The appropriate method is instead to create the trust with the donor holding both interests in the trust.

The donor then contributes the assets to the trust, and finally donates the capital interest to the charity. Of course, the donor would retain the income interest as long as is set out in the trust deed.

GIFTS TO U.S. CHARITIES

Individuals who reside in Canada and commute to their employment or place of business in the United States are allowed to deduct donations made to U.S. charitable organizations on the

same terms as donations made to Canadian organizations.

There are, however, several other important conditions which must be met. Firstly, the commuter must live near the American border during the whole of the taxation year. Secondly, their U.S. employment or business income must represent the donor's chief source of income for that year. Thirdly, the donor must be able to demonstrate that the gift was made to a religious, charitable, scientific, literary or educational organization created or organized in or under the laws of the United States. Finally, they must be able to demonstrate that such a gift would be allowed as a deduction under the United States Internal Revenue Code. Where all those conditions are met, the donations in question are treated as donations made to a registered charity.

VOLUNTEER SERVICES

The *ITA* makes it very clear that only a gift to a charity is receiptable. A gift includes property or a right to property.

Unfortunately, services do not qualify as property and, therefore, are not receiptable.

GIFT BY WILL

One legal requirement of a gift is actual delivery of the gift to the recipient.

However, where a gift is made by Will, such delivery is impossible until after the death of the person– sometimes well after. Under normal circumstances, the gift would not be complete until delivery is made. However, the law allows that where a gift is made by Will, it will be considered to have been made by the deceased in the few seconds preceding death, assuming of course that delivery occurs at some point after the death. In this way, the tax credits that are generated by the donation can be applied to the donor's year of death. This is particularly useful as there is often a large tax bill owing on death.

The law allows for certain differences from a strict calculation perspective. As previously discussed, a donor is generally only entitled to offset 75% of their taxable income using donation tax credits in a given year.

However, in the year of death (i.e. from January 1st until the date of the donor's death) the donor is entitled to offset up to 100% of their income, as filed by their executor. Any unused donation tax credits can be carried back one year, to the year preceding death, and be used to offset 100% of the tax debt owing in that year as well as the tax in the first three taxation years of the estate. One stipulation though is that the gift must be transferred (and accepted) by the qualified donee within three years of the death. Obviously, if the return for the year preceding death has already been filed, then it will be necessary to file an adjustment request to claim the donation tax credits.

APPLICATION OF AMT

The Alternative Minimum Tax (the "AMT") has been part of the income tax system in Canada since 1986, many people have not heard of it because it typically does not apply to people whose main source of income is salary. As the name implies, the idea is that if a Canadian taxpayer would pay less tax under the usual set of calculations than under those required by the AMT, then the individual would be required to pay the higher of the two tax rates.

If someone is required to pay the AMT, they would only be entitled to 80% of the credits that they would otherwise be entitled. And, for donations of publicly listed shares, the individual would still be required to pay tax on 30% of any capital gain realized on the donation.

DIRECTED DONATIONS

A directed donation is one where a donor makes a contribution to a charity with the direction that it be used to support a specific individual. For example, imagine a situation where a donor makes a condition that the money given goes to support a specific individual in need. That concept has been expanded so that a donation that is made with an implicit or explicit direction that the funds be given by way of gift to a non-qualified donee could result in the revocation of the receipting charities registration. So donations with a specific intention should be carefully considered by competent counsel.

BOOKS AND RECORDS

The Canadian income tax system is based upon the principle of honest self-reporting. Consequently, one of the most pervasive issues facing charities is the maintenance of proper books and records. The importance of the issue is underlined when it is understood that charities are usually in the process of proving their innocence rather than disproving their guilt. Without records, this is close to impossible. Indeed, if the charity were to appeal a decision of revocation of its status by the CRA, it would not even be entitled to give oral testimony. So, the importance of well-maintained records is paramount.

What are books and records?

There is no standard definition of books and records. Fundamentally, however, an organization must have sufficient evidence to show that it is in compliance with the Act. To be clear, destroying evidence that an organization is not in compliance will not help the organization, as the lack of documents, in and of itself, is an offence. (Although the documents could be evidence of an offence with a more grievous penalty.)

There is a difference between the two concepts of 'books' and 'records.' 'Books' is not a defined term in the Income Tax Act but is typically understood to be accounting records. A 'record' is defined and includes "an account, an agreement, a book, a charter table, a diagram, a form, an image, an invoice, a letter, a map, a memorandum, a plan, a return, a statement, a telegram, a voucher, and any other thing containing information whether written or in any other form."

No distinction is made in law between corporate and transactional records, but it is helpful to organize a charity by thinking in these terms. Corporate records are those documents required by law to define a corporation and its governance. They are often created with the co-operation of a government office and are required so that the corporation meets certain statutory requirements.

Transactional records are those created by the organization to keep track of its

operations and meetings. They still help the corporation meet its requirements under the law.

Corporate Records

A corporate entity must maintain current copies of its constituting documents (Articles of Incorporation, Articles of Continuance, Letters of Patent, Supplementary Letters of Patent, etc.), bylaws and minutes of meetings or resolutions. Organizations operating in more than one province would also be expected to have copies of their extra-provincial registration.

Meetings

Compliance with the various corporate acts requires minutes of meetings of both directors and members. Members generally meet annually while directors generally meet more often – both should have records of all their formal meetings. If issues are discussed at informal meetings, it is a good idea to make records of those as well. Often, the fact that it had the discussion is in itself valuable and it would be unwise for a charity to self-censor its minutes.

Format

There is no specific requirement that the record of happenings at meetings be kept in any particular way for the CRA's purposes (although for purposes of consistency, groups may wish to follow standard processes). Therefore, meetings that simply have notes of what was said and confirmed as accurate by the bulk of the attendees at the meeting are sufficient for most purposes.

Keep in mind that most corporate statutes do mandate that certain issues be dealt with by the members and/or directors and there may be technical requirements be met in the resolution.

Transactional Records

The vast majority of records held by a charity are its 'transactional' records. They are created by the day-to-day transactions of the organization and include its bank account statements, cheques, records of employee payment, invoices, statements of account, deposit books, etc. These are generally easy records for the organization to obtain as they are created by third parties. The challenge for most charities is to organize these records into some logical format in order that their T3010 can be produced at the end of the year. This role generally falls to a bookkeeper or some other individual prepared to keep these records.

On the assumption that the bulk of these records are being created by a third party, and that the charity simply needs to keep them, the charity will not face any difficulty in ensuring that its transactions are properly maintained.

However, there are situations in which a charity faces difficulties because it is in a non-commercial or non-traditional setting.

Charities that engage in relief of poverty may find it difficult to track the expenditures with which they give alms to the poor. This can be obvious in a situation where the charity distributes food to individuals that simply need it or seem to need it. While the CRA is obviously aware that a charity is engaged in the provision of food for the hungry, it may ask how it can be certain that food is being given only to the poor and is not, for example, being distributed to the employees of the organization or being sold. While the CRA can be forgiving in such situations, it can, in some cases, be extremely difficult to ensure that records are maintained, to demonstrate that the charity's resources are being properly used.

Some foreign countries present another problem in that often the normal transactional records we would expect in Canada – say on the purchase of office supplies – simply may not exist there. Receipts and invoices are simply not used in some parts of the world.

Charities should seek alternate means to track their resources.

Additional Records

Again, while there is no legal definition of 'additional records', these may include emails or letters to the organization — and they may include records that the organization purposely creates in order that the CRA, if it ever looks to see, will accept as proof that the organization is properly meeting its responsibilities.

Emails to and from the organization and letters to the organization must clearly be maintained. Charity officials should be careful to separate out their personal from official comments as an official may be unable to claim privacy over these emails. Moreover, emails between individuals may not necessarily be entered into the charity's records (say in a situation where they are not being saved by a corporate server). In these circumstances, directors should make sure to copy the charity so that the charity's obligations to keep records is met.

Creating Records

The organization may also seek to create records to show that it meets the legal tests involved. For example, to ensure that a charity's resources are properly used in a foreign country the charity may have the volunteers make reports, take pictures or record videos that are not otherwise necessary. Obviously, a charity must first understand the legal principle that it seeks to establish before creating the record. On this point, the charity should seek legal advice before proceeding.

Fundamentally, it is important that a charity understand what it must show in its records to comply with the law should the CRA investigate. Continuous education regarding a charity's obligations is critical so that the administration of the organization understands when to ask for reports of directors or others in whatever circumstances.

Where must they be kept?

The books and records of an organization must be kept, by law, at its registered office address. This, however, is often an impossible task because the legal documents may be more easily kept at a lawyer's office, accounting records may be with the accountant, and other records may be with the organization. It can be inconvenient and costly to keep all the records in one place – particularly if they are voluminous.

The CRA seems to understand the practical difficulties in this aspect and does not, as a matter of course, seek to confirm the location of these records.

During an audit, CRA auditors generally either ask for information to be provided to them or meet at a mutually convenient location where the records are produced.

Nevertheless, we have seen instances where charities lose track of the location of their documents and so it would be wise for an organization to be aware of its records should they have to be produced.

Electronic Record Keeping

Nowadays, more and more records are either created in paper format for conversion to electronic format or in electronic format able to be printed at any time. Obviously, the CRA is as much interested in easy record-keeping as anybody else, and rules do exist for doing so electronically. These rules are outlined in two technical documents from the CRA – IC78-10R5 and IC05-1R1.

An organization that keeps electronic records must be able to provide them in an electronically readable and useable format to the CRA auditors so that they can be read on CRA equipment (although not every CRA department will accept electronic documents). For most modern records this is not an issue if they can be produced in PDF format.

A regular problem is that the organization uses a bookkeeping or accounting software unknown to the CRA. However, as these records can often be converted from one format to another, there is usually a workaround.

Electronic files can be encrypted, but the password must be provided to the CRA if requested.

If a record was originally created in paper format and then converted to electronic, the paper does not need to be kept. However, an electronic record must always be kept, even if converted from one format to another.

The CRA does allow for the keeping of these records online in the cloud.

However, their requirement is that the server be located in Canada or at least that a copy of the records be maintained on a server in Canada.

One difficulty that arises from time to time — and it does not apply only to electronic records — is the accidental destruction of records. With paper records this can happen in terms of a fire or some other disaster. But with electronic records, the loss of a USB key could undermine years of work by the organization. For this reason, electronic records should be copied and kept in safe, redundant locations as much as possible. If records are lost, the CRA may seek proof or a reason for such a loss and may be forgiving in the circumstance. However, there's no guarantee that the CRA will take this approach, and you can assume that the CRA auditors have heard the "dog ate my homework" type of excuse more often than most teachers.

How long to keep records

Generally speaking, all books and records must be kept be for a minimum of six years from the end of the last tax year from which they relate. The tax year end is the same as the fiscal year end for the corporation, but is, by definition, the calendar year end for trusts and unincorporated associations. For purposes of the Employment Insurance Act and the Canada Pension Plan Act, the retention period begins at the end of the calendar year to which the books and records relate.

Technically, duplicate donation receipts of a registered charity (other than receipts for donations of property, which may be held for longer periods of time) is two years from the end of the calendar year in which the donations were made – but it would be inadvisable for a charity to rely on this specific requirement rather than the general one.

The obligations above relate to the *Income Tax Act*, but it is important to understand that obligations also exist in the various corporate acts. Typically, Corporate Records (as opposed to Transactional Records) are not destroyed.

Who Can See Records

Outside of the civil litigation – in which a Plaintiff or Defendant could be compelled to produce documents relating to the litigation – there are really three groups of individuals who may be able to see various parts of corporate records. The directors, the members and government officials each have different levels of access to the charity's records – depending upon the circumstances.

What Language

The law requires that books and records be kept in either English or French.

Organizations that operate overseas typically have records in another language, and while technically the organization should have them translated as they are produced, practically this is often an expensive task. Moreover, CRA audit procedures limit an audit to a certain number of years, translating every document as it comes through may be unnecessary for years that are not under audit.

Even for years under audit, the CRA at times requests just sample documents, so the charity may be in the position of translating documents that will never be read.

Generally, the CRA allows a period of time to produce documents and understands that organizations operating in non-English or French-speaking parts of the world will have documents in other languages. Indeed, if someone sends an email to an organization in a language that is not English, the organization can hardly be faulted for the fact that its books and records are only in English or French.

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