

BUDGET 2015: INCENTIVIZING CHARITABLE GIVING AND EASING INVESTMENT RESTRICTIONS ON CHARITIES AND RCAAAS

Posted on April 28, 2015

Categories: [Insights](#), [Publications](#)

Budget 2015 announced three proposals to amend the *Income Tax Act* (Canada) (the "**Tax Act**") that are designed to further incentivize charitable giving to registered charities ("**Registered Charities**") and other "qualified donees" ("**Qualified Donees**") and to ease investment restrictions on the activities of certain Registered Charities and registered Canadian amateur athletic associations ("**RCAAAs**"). It is anticipated that these welcome proposals will benefit both Qualified Donees and donors.

Donations Involving Private Corporation Shares or Real Estate

Taxpayers that donate to Qualified Donees are generally eligible for a tax credit, in the case of individuals, or a tax deduction, in the case of corporations, in respect of the donation. In addition, taxpayers that make donations of shares, debt obligations or rights listed on a designated stock exchange to Qualified Donees, as well as certain other specified types of property, including units of mutual fund trusts and shares of mutual fund corporations, (collectively, "**Publicly Traded Securities**") are generally exempt from capital gains tax that would otherwise arise on the donation. Notwithstanding the absence of capital gains taxation in such circumstances, a taxpayer will generally receive a donation receipt for the fair market value of the Publicly Traded Securities at the time of the donation.

By contrast, a donor is generally not relieved from capital gains tax that arises on the donation of private corporation shares or non-ecologically sensitive real estate. Accordingly, a donor of private corporation shares or real estate to a Qualified Donee would generally be subject to capital gains taxation on any gain realized on the disposition. The donor would continue to be entitled to a donation receipt for the fair market value of the donated property at the time of the donation (in such circumstances, a donor may, subject to certain limits, elect to designate on the donor's annual tax return an amount that is lower than the fair market value of the property as both the proceeds of disposition and amount of the donation, thereby lowering both the capital gain recognized on the donation, as well as the amount of the donation credit or deduction, as applicable, that would otherwise have been available in respect of the gift).

The charitable sector has made several representations to the Department of Finance in recent years requesting that the exemption from capital gains taxation available in respect of donations of Publicly Traded Securities be extended to include donations of shares of private corporations and real estate.

Budget 2015 proposes to provide an exemption from capital gains tax in respect of certain dispositions of private corporation shares and real estate. Such an exemption will be available where:

- cash proceeds from the disposition of the private corporation shares or real estate are donated to a Qualified Donee within 30 days after the disposition; and
- the private corporation shares or real estate are sold to a purchaser that is dealing at arm's length with both the donor and the Qualified Donee to which cash proceeds are donated.

It is proposed that the exempt portion of the capital gain will be determined with reference to the proportion that the cash proceeds that are donated is of the total proceeds from the disposition of the private corporation shares or real estate.

A series of anti-avoidance measures have also been proposed to limit the scope and availability of the above exemption to targeted dispositions of private corporation shares and real estate. In particular, the anti-avoidance measures appear to be designed to ensure that a deduction is not claimed when the donor, or a person not dealing at arm's length with the donor, has not effectively divested itself of the donated property or has subsequently reacquired such donated property.

The anti-avoidance rules will apply where, within five years after the disposition:

- the donor (or a person not dealing at arm's length with the donor) directly or indirectly reacquires any property that had been sold;
 - in the case of shares, the donor (or a person not dealing at arm's length with the donor) acquires shares substituted for the shares that had been sold; or
 - in the case of shares, the shares of a corporation that had been sold are redeemed and the donor does not deal at arm's length with the corporation at the time of the redemption.
- Where the anti-avoidance rules apply, a taxpayer will be required to include the previously exempt taxable capital gain in the taxpayer's income in the year of the reacquisition or redemption.

The above proposal to exempt donations of private corporation shares and real estate from capital gains tax is structured differently than the exemption that applies in the case of Publicly Traded Securities. For a donor to avail himself or herself of the existing exemption from capital gains tax, the Publicly Traded Securities must be donated in-kind to the Qualified Donee. Generally, a Qualified Donee wishing to provide this option to its donors must open a brokerage account or otherwise ensure that it is equipped to receive donations of Publicly

Traded Securities. This can be administratively burdensome, particularly to smaller Qualified Donees or in circumstances where the value of the donated Publicly Traded Securities is relatively modest. In contrast, the Budget 2015 proposal to exempt donations of private corporation shares and real estate from capital gains tax does not require the transfer of ownership of the shares or real estate to the Qualified Donee. Budget 2015 proposes that the proceeds from a sale to a third party may be donated to a Qualified Donee within 30 days after the disposition of the subject property. It is hoped that the Government considers streamlining the rules in respect of donations of Publicly Traded Securities such that donors may similarly be exempt from capital gains taxation without having to transfer the Publicly Traded Securities to Qualified Donees.

Budget 2015 did not release draft legislation in respect of the above proposal. However, the Budget documentation suggests that the proposed rules would apply to donations made in respect of dispositions occurring after 2016.

Investments by Registered Charities and RCAAAs in Limited Partnerships

Subject to various restrictions, Registered Charities and RCAAAs are generally permitted to make passive investments of surplus funds in order to increase the assets at their disposal to carry out their charitable activities. Private foundations are generally not permitted to engage in business activities to earn additional revenue, while charitable organizations, public foundations and RCAAAs are generally only permitted to engage in business activities in circumstances where the business is a "related business". Broadly speaking, a related business is one that is run substantially by volunteers or one that is linked to an organization's purpose and is subordinate to that purpose.

A partnership is a legal relationship governed by provincial law typically pursuant to which persons may carry on business in common with a view to profit. Since a partnership is not recognized as a legal person, the partnership's activities are generally considered to be the activities of the individual partners. Accordingly, a Registered Charity or RCAA that invests in a partnership will generally be considered to be carrying on the business of the partnership. As noted above, private foundations are prohibited from carrying on a business and, therefore, from owning a partnership interest, while charitable organizations, public foundations and RCAAAs may generally only own an interest in a partnership if the partnership carries on a related business to the Registered Charity or RCAA, as applicable.

Budget 2015 recognizes that partnerships are used extensively as investment vehicles to pool funding by institutional and other large investors in order to invest in private market opportunities. Budget 2015 also recognizes that limited partnerships can be used to structure social impact investments, which can address social and economic needs. Accordingly, Budget 2015 proposes to amend the Tax Act to provide that Registered Charities and RCAAAs will not be carrying on a business solely because they acquire or hold an

interest in a limited partnership.

Budget 2015 proposes to include certain restrictions on the holding of limited partnership interests by Registered Charities and RCAAs to ensure such holdings are merely passive investments. Accordingly, the relieving measure is only proposed to apply where:

- the Registered Charity or RCAA – together with all non-arm's length entities – holds 20% or less of the interests in the limited partnership; and
- the Registered Charity or RCAA deals at arm's length with each "general partner" of the limited partnership.

These restrictions would not apply to situations where a charitable organization, public foundation or RCAA carries on a related business through a limited partnership.

Budget 2015 proposes to make certain corresponding changes to the excess corporate holdings regime, which generally places limits on the shareholdings of private foundations. Budget 2015 proposes to disregard, or "look through", limited partnerships in assessing a private foundation's holdings. Similarly, Budget 2015 proposes to amend certain anti-avoidance provisions in the Tax Act related to non-qualifying securities and the loanback rules that apply to donations of shares. Following such amendments, it is understood that the non-qualifying security rules and the loanback rules will also apply to donations of interests in limited partnerships.

While the proposed legislative amendments relating to investments in limited partnerships are welcome, care will need to be taken by Registered Charities and RCAAs to ensure that, among other things, they do not take part in the control of the business of the partnership, run afoul of the naming restrictions in the operative limited partnership statute, or otherwise take actions that may compromise their limited liability as a member of the partnership.

Budget 2015 proposes to apply these measures in respect of investments in limited partnerships that are made or acquired after April 20, 2015.

Gifts to Foreign Charitable Foundations

As summarized above, Taxpayers that donate to Qualified Donees are generally eligible for a tax credit, in the case of individuals, or a tax deduction, in the case of corporations, in respect of the donation. Budget 2015 proposes to expand the list of entities that are characterized as Qualified Donees to include certain foreign charitable foundations.

Currently, the definition of Qualified Donee in the Tax Act includes several categories of domestic and foreign entities including, among others, Registered Charities, municipalities, the federal and provincial governments,

and certain international bodies such as the United Nations.

Also included in the list of organizations that are Qualified Donees are certain foreign organizations that have applied to the Minister of National Revenue (the "**Minister**") to be recognized as Qualified Donees for a two-year term. It is open to the Minister to register, in consultation with the Minister of Finance, such an organization if:

- the federal government has made a gift to the organization within the previous two years;
- the foreign organization is a charitable organization that is not resident in Canada; and
- the foreign organization is:
 - carrying on relief activities in response to a disaster;
 - providing urgent humanitarian aid; or
 - carrying on activities in the national interest of Canada.

Budget 2015 proposes to amend the Tax Act to expand the category of foreign charities that are eligible to apply to the Minister to be a Qualified Donee to include charitable foundations in addition to charitable organizations.

Whereas charitable organizations are generally required to carry out their own charitable activities, charitable foundations have greater latitude to fulfill their charitable mandate by disbursing funds to other permitted persons.

Such a change should be welcomed by Canadian donors wishing to donate to certain international charitable foundations. It appears that the prior restrictions on the Minister from designating a foreign charitable foundation as a Qualified Donee (for a limited 24-month period) was unnecessarily restrictive, particularly since the Crown effectively controls the designation process because only foundations that have received a gift from the federal government may apply to be a Qualified Donee for this purpose.

This proposed measure will apply once the enacting legislation receives Royal Assent.

by Andrew Stirling

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

© McMillan LLP 2015