

**Border Patrol Around the World:  
Private and Public Benefit in Canadian Charity Law<sup>1\*</sup>**

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**Introduction<sup>3</sup>**

Canadian charity law is based largely upon an amalgam of English common law trust doctrines<sup>4</sup> and Canadian federal income tax law<sup>5</sup>. Both Anglo-Canadian common law and Canadian tax law contain requirements that charitable organizations operate for the public benefit and do not provide for excessive private benefit.

One might suggest that the essential attribute of charitable activity is that it seeks the welfare of the public; it is not concerned with the conferment of private advantage. This paper will examine the development of the legal concept of charity and charitable status in keeping with these principles. It will start out by first looking at the emergence of charity and its subsequent development under English jurisprudence. Next, it will examine the evolution of these same concepts under Canadian jurisprudence. Finally, it will examine some of the Canadian tax rules that apply and the sanctions that may be imposed where private benefit exists or might exist.

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<sup>4</sup> See the last pre codification editions of the English charity law texts such as Peter Luxton, *The Law of Charities* (Oxford: Oxford University Press, 2001) and the one detailed Canadian text to cover charitable trust law, DWM Waters, Mark R. Gillen & Lionel D. Smith eds, *Waters' Law of Trusts in Canada*, 3rd ed (Toronto: Thomson Carswell, 2005) for additional background.

<sup>5</sup> See Arthur B.C. Drache, Robert B. Hayhoe & David P. Stevens, *Charities, Taxation, Policy and Practice* (Toronto: Thomson Carswell, loose-leaf 2011), for more detail on Canadian charity tax law.

## Implications of Charitable Status in Canada

In Canada, charitable status is important in large part because of its income tax implications. An organization that is registered with the Canada Revenue Agency as a charity is exempt generally from income tax.<sup>6</sup> As well, gifts to a registered charity entitle donors to generous tax credits (individuals)<sup>7</sup> or tax deductions (corporations)<sup>8</sup>. While the Attorney General of each Canadian province does have *parens patriae* jurisdiction over charities in the province,<sup>9</sup> an implication of the tax benefits of charitable status has been that the charitable sector has largely been regulated of late in Canada from the perspective of limiting tax revenue loss.<sup>10</sup>

## Development of the Meaning of Charity and Charitable Status

In order to assess the modern meaning of ‘charity’ and ‘charitable’ within the Canadian context, it is important to first understand the considerable lineage of English case law that has led to its development. The following will be, of course, a mere summary, because of space limitations and because the underlying English law on the issue is being covered by another panelist.

The decision in *Income Tax Special Purposes Commrs. v. Pemsel*<sup>11</sup>, commonly referred to as *Pemsel’s Case*, is applied in Canada as providing the primary major judicial classification of charitable purposes and charitable objects. Lord Macnaghten, in writing for the majority of the House of Lords, found in favour of the Church. He outlined four principal categories of charitable purposes:

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<sup>6</sup> *Income Tax Act*, R.S.C. 1985, c. 1 (5<sup>th</sup> Supp.), s.149(1)(f). All statutory references are to the *Income Tax Act* unless otherwise noted.

<sup>7</sup> S.118.1.

<sup>8</sup> S.110.1.

<sup>9</sup> Jurisdiction over charities is ostensibly a matter of provincial jurisdiction in Canada: *Constitution Act*, 1867, U.K., 30 & 31 Victoria, c. 3, s.92(7).

<sup>10</sup> For example, see *News to You Canada v. M.N.R.*, 2011 FCA 192, in which the Federal Court of Appeal upheld the Canada Revenue Agency’s refusal to register the Appellant as a charity, in part because of the perceived fiscal impact of so doing.

<sup>11</sup> [1891] A.C. 531 (H.L.).

“Charity” in its legal sense comprises four principal divisions: trusts for the relief of poverty; trusts for the advancement of education; trusts for the advancement of religion; and trusts for other purposes beneficial to the community, not falling under any of the preceding heads.<sup>12</sup>

Although Lord Macnaghten in *Pemsel’s Case* did not qualify his fourth head, it is clear that not all purposes beneficial to the community are charitable. A purpose under the fourth head must still be either expressed in, or analogous to purposes expressed in, the Preamble to what is known as the *Statute of Elizabeth*<sup>13</sup>. In other words, the purpose must still fall either within the letter or within the spirit and intendment of the Preamble.<sup>14</sup> The fourth head of *Pemsel* therefore covers a wide range of purposes. It becomes impossible to enumerate all the purpose for the benefit of the public that are capable of falling within the spirit and intendment of the Preamble.<sup>15</sup>

An essential element in all four divisions of charitable objects or purposes is whether or not there is a public benefit. There must be a public benefit for the object or purpose of the organization to be charitable in its legal sense.<sup>16</sup> Whether or not an object or purpose has a public benefit is a question of fact, based upon the evidence presented before the court.<sup>17</sup>

In addition, the public benefit, to be viewed as charitable, must benefit the whole community or a significant party of an “appreciably important class within the community.”<sup>18</sup> What makes up a sufficient or significant part of the community is not a formulaic definition, but rather assessed on a case-by-case basis. However, English courts have previously stated that in order to meet this threshold, potential beneficiaries must not be numerically negligible, and the quality which distinguishes them from other members of

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<sup>12</sup> [1891] A.C. 531 (H.L.) at 583.

<sup>13</sup> *Statute of Uses*, (Imp.), 1601, 43 Eliz. 1, c. 4.

<sup>14</sup> Peter Luxton, *The Law of Charities* (Oxford: Oxford University Press, 2001), at 185.

<sup>15</sup> *Ibid*, at 138.

<sup>16</sup> Donald J Bourgeois, *The Law of Charitable and Not-for-Profit Organizations*, 3rd ed (Markham, Ontario: Butterworths Canada Ltd., 2002), at 14.

<sup>17</sup> *National Anti-Vivisection Society v. IRC*, [1948] A.C. 31, [1947] 2 All E.R. 217, at 219 (H.L.).

<sup>18</sup> *Supra* note 16, at 14.

the community must be a quality which does not depend upon their relationship to a particular individual.<sup>19</sup>

The assessment of this component of the test depends upon the charitable object or purpose being questioned. Certainly, the benefit cannot be a private one, in which the numbers are so insignificant that the general public does not benefit from the object or purpose.<sup>20</sup> The concept of public benefit appears to be based on a common understanding within society. What is or is not a public benefit, therefore, is not static but will develop as the common understanding evolves. It will depend upon the social conditions at the time of the assessment.<sup>21</sup>

It is important to note that the meaning of charity also changes over time. In the *National Anti-Vivisection Society* case, Lord Simonds said that a change in social habits and needs, or a change in the law, or increased knowledge and expertise, may result in a purpose which once appeared to be beneficial, being seen to be truly detrimental to the community.<sup>22</sup>

### Common Law Considerations: The Canadian Approach

When examining the English jurisprudence, it is important to remember that there are no similar comprehensive legislative provisions governing Canadian charities. Only Ontario has legislation that is intended to administratively regulate certain aspects of charitable organizations – the *Charitable Gifts Act*<sup>23</sup>, the *Charitable Institutions Act*<sup>24</sup>, and the *Charities Accounting Act*.<sup>25</sup>

The *Charities Accounting Act* provides some guidance as to definition. It defines charitable purpose as being: relief of poverty; advancement of education; advancement of

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<sup>19</sup> *Oppenheim v. Tobacco Securities Trust Co.*, [1951] 1 All E.R. 31 (H.L.).

<sup>20</sup> *Supra* note 16, at 14.

<sup>21</sup> *Ibid*, at 16.

<sup>22</sup> *National Anti-Vivisection Society v. IRC* [1948] AC 31, at 74 .

<sup>23</sup> R.S.O. 1990, c. C. 8.

<sup>24</sup> R.S.O. 1990, c. C. 9.

<sup>25</sup> R.S.O. 1990, c. C. 10, sec. 7.

religion; or, any other purpose beneficial to the community not falling under the other three purposes. Thus, this definition adds nothing to the common law.

In Canada, registered charities (which may or may not be corporations) are organizations that operate for the benefit of the public and have been established exclusively for one or more of the four recognized charitable purposes: the relief of poverty, the advancement of religion, the advancement of education, or other purposes beneficial to the community.

The Canadian jurisprudence on charities and charitable purposes has developed tangentially to the line of English case law that has formed the basis for much of the common law world's understanding of these concepts. The four categories of charitable purposes developed in England have formed the basic concept and definition of charity in Canada. The first three divisions are assumed generally to contribute to public benefit. However, the fourth division is understood to be more open-ended and vague. Therefore, the problem becomes determining what is not beneficial to the community or the public in a charitable sense, and is instead consistent with a private benefit.<sup>26</sup> The test in Canada has remained consistent with Lord Macnaghten's decision. The charitable activity must fall under one of the four heads of charity, and be concerned with public benefit.

The first head of charity is the relief of poverty. Most Canadian common law continues to rely on the preamble to the Statute of Elizabeth as an aide in understanding this purpose.<sup>27</sup> This raises important questions as to what forms of want are comprised within the relief of poverty as a head of charity, as well as the required degree of financial need in order to qualify for this relief. Modern cases and interpretations have understood both financial need and relief of distress and suffering to fall under the "relief of poverty" head.

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<sup>26</sup> *Supra* note 16, at 18.

<sup>27</sup> DWM Waters, Mark R Gillen & Lionel D Smith eds, *Waters' Law of Trusts in Canada*, 3rd ed (Toronto: Thomson Carswell, 2005), at 681.

The second head of charity is the advancement of education. Not only have all activities of universities and colleges been brought within this head of charity, on the ground that they are institutions whose basic purpose is the furthering of education, but education has been held to embrace a wide range of cultural pursuits and activities in the arts having no connection with universities and schools.<sup>28</sup> In *Yorkshire & Canadian Trust Ltd. v. Atherton*, Fisher J. suggested that the test of education is whether aid or benefit to others is involved in the carrying out of the purpose, and whether it can be said that the carrying out of the purpose would tend towards the edification or instruction of the public.<sup>29</sup> In Canada, educational institutions are still presumed to operate for the public benefit by virtue of being educational and there has been no particular suggestion that private schools must provide places to poor students to be charitable (though most do).

The third head of charity is the advancement of religion. In Canada, the common law courts have followed largely the English courts and decisions in the sense that they, too, have first recognized the preamble's reference to the repair of churches and have proceeded from that point.<sup>30</sup> Again, Canadian common law still presumes that religious charities operate for the public benefit.

The fourth and last head of charity is that of other purposes beneficial to the community. This category was based on a group of purposes which were diverse in nature, but where no particular purpose was dominant.<sup>31</sup> English commentaries have broken down these purposes into sub-heads, including: trusts for the provision of social and recreational facilities, for the relief of distress and suffering, for the welfare of animals, for relief work overseas, and for the promotion of health are just some of the purpose distinctions that are usually evident.<sup>32</sup> These have been followed and expanded upon by Canadian authorities,

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<sup>28</sup> *Ibid*, at 694.

<sup>29</sup> [1941] 3 W.W.R. 513

<sup>30</sup> *Supra* note 27, at 705.

<sup>31</sup> *Ibid*, at 720.

<sup>32</sup> *Ibid*, at 721.

which also include as sub-heads the support and care of ex-service personnel, among others.<sup>33</sup>

The second part of the test in Canada involves identifying whether or not a public benefit as opposed to a private benefit is derived from the charitable activity or purpose. It is important to keep in mind an activity that furthers the public good is not necessarily a purpose beneficial to the community.<sup>34</sup> The consideration of public benefit is two-fold. Firstly, a tangible benefit must be conferred, directly or indirectly. Secondly, the benefit must have a public character. Moreover, the charity must benefit the public generally, or a sufficient segment of the public in order to become a registered charity in Canada.<sup>35</sup>

Thus, in addition to the need to fit a purpose into one of the four heads of charity, there is a need for the application of the purpose to benefit a sufficiently wide segment of the public and to benefit the public in a helpful way.

### **Tax Rules on Private Benefit**

As discussed, Canadian charities, and gifts to them, enjoy significant tax exemptions and reliefs. As some of the fiscal advantages are very specific in scope, to derive maximum benefit from them charities and donors may need to arrange their giving and to organize their activities in particular ways.<sup>36</sup> However, it is important to note that administrative and legislative limits have been put in place by the Canada Revenue Agency and Parliament in order to limit tax relief to appropriate situations.

### **Definition**

The first Canadian tax limit on private benefit flows from the very definition of registered charity. The *Income Tax Act* divides registered charities into charitable organizations and charitable foundations. It defines charitable foundations to require that

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<sup>33</sup> *Ibid*, at 725.

<sup>34</sup> *Ibid*, at 731.

<sup>35</sup> *Ibid*, at 689.

<sup>36</sup> *Supra* note 14, at 62.

they be “constituted and operated exclusively for charitable purposes.”<sup>37</sup> Similarly, the Income tax Act also defines a charitable organization as being one “all of its resources of which are devoted to charitable activities carried out by the organization itself.”<sup>38</sup> Both the reference to exclusively charitable purposes and to charitable activities are interpreted to require compliance with the common law definition of charity described above, including the requirements for public benefit.

As well, the *Income Tax Act* definitions of charitable organization and private foundation and public foundation all provide that the income of the charity may not be payable or made available for the personal benefit of any proprietor, member, shareholder, trustee, or settlor that is not a charitable organization.<sup>39</sup>

However, this limitation applies only to income. Where payment is made for legitimate expenses of the charitable organization, the requirement is not breached because the cost of the expense is a proper deduction from income. Thus, the charity can as a matter of tax law at least<sup>40</sup>, legitimately pay reasonable salaries and fees to people in the enumerated class, as well as reimburse them for expenses.<sup>41</sup>

Furthermore, where a member receives funds from the charity and that person falls into the category of a legitimate recipient of the charity’s largess, the charity should not be considered to be in breach. However, caution should be exercised where charitable assistance is extended to a person who falls into the proscribed group in order that the

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<sup>37</sup> s.149.1(1).

<sup>38</sup> *Ibid.*

<sup>39</sup> *Ibid.*

<sup>40</sup> Although this paper will not provide a detailed analysis of the position, the dominant view, in Ontario at least, is that the directors or an incorporated charity may not be paid by or otherwise benefit from their service to the charity absent statutory permission or a court order and charitable trustees may only be paid if the instrument creating the charitable trust so permits. This is perhaps a view not always followed. Note as well that in Ontario, there is a process for obtaining an approving court order on consent of the Public Guardian and Trustee.

<sup>41</sup> Arthur BC Drache, Robert B Hayhoe & David P Stevens, *Charities, Taxation, Policy and Practice*, loose-leaf (consulted on 28 September 2011), at 5-9.



charity be able to show that the recipient received the charitable benefit as a charitable benefit instead of as a disguised private benefit.<sup>42</sup>

### Undue Benefit Intermediate Sanction<sup>43</sup>

There is in Canada a penalty system in place to address violations of charity tax rules, and benefit rules in particular. Until recently, the Canadian tax system provided the Canada Revenue Agency with only one real sanction against a registered charity that violated the charity tax rules – revocation of the charity’s registration.<sup>44</sup> Under the old regime, the CRA had the authority to audit the operations of a charity to determine compliance with the charity tax rules. However, if it found that there was an instance of non-compliance, the only sanction available was the revocation of the charity’s registration. Revocation results in the charity’s immediate loss of both tax-exempt status and the ability to issue tax receipts. Thus, any subsequent donors were denied the benefit of tax recognition for gifts to the charity.<sup>45</sup> A further, more punitive sanction consists of the fact that one year after revocation, the charity would be subject to revocation tax equal to all of its assets at the time of revocation, less deductions for legitimate expenses and grants to other registered charities made within the previous year.<sup>46</sup>

In 2005, the *Income Tax Act* was amended to introduce intermediate sanction taxes. The sanctions, found in section 188.1, are applicable to taxation years after March 22, 2004. The provisions indicate the tax or other penalty imposed for each type of infraction of the charity tax rules. The purpose behind the introduction of these provisions is two-fold. First, they act as an inducement to comply; they are intended to persuade

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<sup>42</sup> *Ibid*, at 5-10.

<sup>43</sup> For a comparison of the Canadian rule with its US counterpart, see: Hayhoe, Robert & Marcus S Owens, “The New Tax Sanctions for Canadian Charities: Learning from the US Experience” (2006) 54 *Canadian Tax Journal* 57.

<sup>44</sup> *Ibid*, at 58.

<sup>45</sup> *Ibid*, at 67.

<sup>46</sup> *Income Tax Act*, section 188.

organizations to comply with the law. Second, in instances where they fail to act as a deterrent, the provisions provide a clear penalty for non-compliance.<sup>47</sup>

The penalties and sanctions available vary based on the nature of the offence and whether it is a first-time or repeat offence. If a particular offence is repeated within five years of the first penalty assessment, sanctions are increased for the subsequent offence.<sup>48</sup> If a charity is subject to a penalty tax under the *Income Tax Act* of more than \$1,000 in a given year, the charity has the option of paying all or part of the penalty to an eligible donee (essentially another charity with arm's length governance), instead of remitting the entire penalty tax to the government; this is unique to the Canadian system.<sup>49</sup> However, Canadian intermediate sanctions are not imposed on a self-assessment basis.<sup>50</sup>

As part of the prohibitions on private benefit, subsection 188.1(4) provides that in the event that a registered charity is found to be conferring an “undue benefit”<sup>51</sup> upon a person, the applicable intermediate sanction against the charity is a penalty of 105 percent (or 110 percent in the case of a repeat infraction) of the amount of the undue benefit. Furthermore, for a repeat infraction, subsection 188.2(1) requires the minister to suspend the charity's receipting privileges unless the undue benefit was a gift.

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<sup>47</sup> *Supra* note 43.

<sup>48</sup> *Income Tax Act*, subsection 188.1(2), paragraphs 188.1(3)(b) and (4)(b), and subsections 188.1(8) and 188.2(1).

<sup>49</sup> *Supra* note 43, at 82, and see subsections 189(6.2) and (6.3).

<sup>50</sup> *Ibid.*, at 83.

<sup>51</sup> Defined in subsection 188.1(5) of the *Income Tax Act* as follows:

(5) For the purposes of this Part, an undue benefit conferred on a person (referred to in this Part as the “beneficiary”) by a registered charity includes a disbursement by way of a gift or the amount of any part of the income, rights, property or resources of the charity that is paid, payable, assigned or otherwise made available for the personal benefit of any person who is a proprietor, member, shareholder, trustee or settlor of the charity, who has contributed or otherwise paid into the charity more than 50% of the capital of the charity, or who deals not at arm's length with such a person or with the charity, as well as any benefit conferred on a beneficiary by another person, at the direction or with the consent of the charity, that would, if it were not conferred on the beneficiary, be an amount in respect of which the charity would have a right, but does not include a disbursement or benefit to the extent that it is

(a) an amount that is reasonable consideration or remuneration for property acquired by or services rendered to the charity;

(b) a gift made, or a benefit conferred, in the course of a charitable act in the ordinary course of the charitable activities carried on by the charity, unless it can reasonably be considered that the eligibility of the beneficiary for the benefit relates solely to the relationship of the beneficiary to the charity; or

(c) a gift to a qualified donee.

An undue benefit has been defined to include a gift (other than to a qualified donee) or a payment to a member, trustee, or significant donor, or a person not dealing at arm's length with such a person. Amounts paid as reasonable remuneration for goods and services and gifts made in the course of charitable activity (unless the only reason for the beneficiary's eligibility was a relationship with the charity) are excluded from the definition of an undue benefit.<sup>52</sup>

As it is currently laid out, the definition of undue benefit catches a number of discrete scenarios. One example of this is excessive salary for senior management. The Canadian undue benefit sanction also encompasses excessive payment to non-arm's length fundraisers. It could be used to attack payments by Canadian charities to foreign affiliate charities.

#### Prohibition of Circular Fund Flow

Section 188.1(11) addresses the situation in which two registered charities engage in a reciprocal gifting arrangement in order to delay spending amounts on charitable activities (which could be viewed by the Canada Revenue Agency as a form of private benefit). In this type of an arrangement, two charities could transfer an amount back and forth in alternating years in order to meet their disbursement quota for the year in which the transfer is made. Charities that take this approach to disbursement quota compliance will be jointly and severally liable for tax of 100 percent of the transferred amount.<sup>53</sup> In addition to this sanction, the respective charities may also be subject to revocation of their registration.<sup>54</sup>

#### Tax Good Governance Principles<sup>55</sup>

The concept of and approach to good governance as it relates to Canadian charities have evolved significantly in Canada as a result of the introduction of the 2011 Federal

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<sup>52</sup> *Supra* note 43, at 75.

<sup>53</sup> *Supra* note 43, at 80.

<sup>54</sup> *Income Tax Act*, subsection 149.1(4.1).

<sup>55</sup> For more detail, see R.B. Hayhoe and R. Sharma, "Punitive New Charity Governance Rules Introduced into Canadian tax System" (forthcoming 2011), *STEP Journal*.

Budget. This Budget gives the Canada Revenue Agency a very significant role in policing charity governance control. The changes are, in part, aimed a punishing and preventing private benefit transactions.

The government believes that there is a pattern of the same individuals being involved in multiple abusive charities. In order to curb this type of abuse, the new rules allow the CRA discretion to refuse to register an applicant or to revoke an existing charity or to suspend its receipting ability if any individual director, officer, or person who otherwise controls or manages the charity has engaged in certain kinds of activities. These activities include: being convicted of any crime, in Canada or elsewhere, involving financial dishonesty or that is otherwise relevant to the organization; being convicted of a regulatory offence, in Canada or elsewhere, within the past five years, involving financial dishonesty, or that is otherwise relevant to the organization; having been a director, officer, or person who otherwise controlled or managed a charity or Canadian amateur athletic association that engaged in serious non-compliance for which its registration was revoked within the past five years; and, having been a promoter of a charitable donation tax shelter involving a charity that was revoked in the past five years for participation in the shelter.

### Split-Receipting

In 2001, amendments were proposed to the Income Tax Act to permit split receipting whereby a donor who received some benefit related to the donor's gift would be able to receive tax recognition for the difference between the value of the property transferred to the charity and the benefit received. Previously, it had been the view of the Canada Revenue Agency that any benefit, whoever minor, vitiated the gift. Although the 2001 amendments have not yet been passed by parliament, they are being applied as a matter of administrative policy by the Canada Revenue Agency. In 2002, the 2001 proposals were amended to add an overlay of anti-avoidance provisions to them.

The Anti-avoidance overlay was aimed at closing various charitable donation tax shelter programs whereby donors would acquire property at a discount and donate it at

retail value, or where donors would borrow money to donate, yet somehow avoid paying back the borrowed funds. While the schemes were complex, they were all designed to cause participants to be ahead on a cash flow basis from where they would have been had the “gift” not been made.<sup>56</sup>

In essence, the anti-avoidance rules did two things. First, they defined the advantage (the amount by which a gift is reduced to account for donor benefit) very broadly<sup>57</sup> to include any benefit (itself defined to include a non-recourse debt<sup>58</sup>) to the donor or to someone dealing not at arm’s length with the donor. Second, they also provided that the donation value of most capital property donated to a registered charity was to be reduced to the donor’s acquisition cost if the property had been acquired within three years of donation or had been acquired within ten years of donation but with the intention to give being present at acquisition.<sup>59</sup>

### Excess Corporate Holdings Limitations

The *Income Tax Act* was amended in 2008<sup>60</sup> to introduce limits on the ability of private foundations to hold company shares. These limits were designed to prevent self dealing between private foundations and corporations owned by their principals. Although very complex, these rules operate to apply a tax (or revocation) to any charity that holds (together with others who do not deal with it at arm’s length with it) more than

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<sup>56</sup> For more detail, see R.B. Hayhoe and A. Stacey, "The Continuing Saga of Charitable Donation Tax Shelters in Canada" (2008), 61:2, *Exempt Organization Tax Review* 159

<sup>57</sup> s.248(32): The amount of the advantage in respect of a gift or monetary contribution by a taxpayer is the total of

(a) the total of all amounts, other than an amount referred to in paragraph (b), each of which is the value, at the time the gift or monetary contribution is made, of any property, service, compensation, use or other benefit that the taxpayer, or a person or partnership who does not deal at arm's length with the taxpayer, has received, obtained or enjoyed, or is entitled, either immediately or in the future and either absolutely or contingently, to receive, obtain, or enjoy

(i) that is consideration for the gift or monetary ,

(ii) that is in gratitude for the gift or monetary contribution, or

(iii) that is in any other way related to the gift or monetary contribution, and

(b) the limited-recourse debt, determined under subsection 143.2(6.1), in respect of the gift or monetary contribution at the time the gift or monetary contribution is made

<sup>58</sup> As defined in s. 143.2(6.1).

<sup>59</sup> s.248(35).

<sup>60</sup> By the addition of s.149.2.

20% of the shares of any class of a corporation (whether the corporation is private or public). Lower holdings give rise to a public disclosure obligation.

### Non-Qualified Investments

The *Income Tax Act* provides that if a private foundation holds certain investments in non-arm's length entities, the foundation will be taxed on returns that are deemed to be insufficient (on the theory that these returns may have been siphoned off to management or other shareholders). This rule applies to a "non-qualified investment"<sup>61</sup> which is essentially a debt owing to the foundation by a non-arm's length person or a share of a private corporation controlled by a person who is non-arm's length to the foundation. In particular, if a private foundation holds a non-qualified investment, the foundation will be liable for a tax equal to the difference between the foundation's actual income stream from the investment and a prescribed expected income.<sup>62</sup>

### Non-Qualifying Securities

In addition to the non-qualified investment rules described above, the *Income tax Act* also contains limits on the ability of a donor to receive tax recognition for certain gifts. A gift of property that is a "non-qualifying security"<sup>63</sup> is deemed for the purpose of the donor's charitable giving not to have been made.<sup>64</sup> A non-qualifying security is defined (simplifying substantially) as an obligation of the donor or a private company share where the donor does not deal at arm's length with the corporation. If a registered charity receives a gift of non-qualifying securities, the donor receives no tax recognition unless the charity disposes of the securities within 5 years.

### **Conclusion**

Thus, the Canadian charity law limit on private benefit and requirement for public benefit come from English common law, but have now been backed up by specific tax

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<sup>61</sup> Defined in s.149.1(1).

<sup>62</sup> S.189.

<sup>63</sup> S.118.1(18).

<sup>64</sup> S.118.1(13).

limits and penalties also aimed at private benefit. These tax rules have added significant complexity to the charity regulatory system in Canada.