

FOCUS

ON WILLS, ESTATES, CHARITIES, & TRUST

Revenue agency gets tough with charities

The Canada Revenue Agency is cracking down on donation tax shelters.

As part of its get-tough act the Canada Revenue Agency (CRA) issued a notice of suspension to the International Charity Association Network (ICAN), a registered charity under the *Income Tax Act* (ITA) for a one-year period commencing Nov. 28, 2007. During this period, ICAN is prohibited from issuing official income tax receipts for donations made to it, but has not been precluded from carrying out its charitable activities.

This was the first sanction of this sort imposed by CRA since Parliament passed legislation in 2005 implementing new rules concerning the taxation and administration of charities, including new intermediate sanctions.

CRA has since issued a second notice of suspension, this time to Adath Israel Congregation ("Adath") in Montreal for a one-year period commencing March 19, as well as levied a penalty of \$499,055 against Adath. This appears to be the first imposed under the new intermediate sanctions.

Both situations highlight compliance issues for all registered charities not fulfilling the extensive reporting requirements outlined in the ITA, as well as setting the framework for interlocutory applications relating to the intermediate sanctions.

ICAN applied to the Tax Court of Canada for a postponement of the suspension (*International Charity Association Network v. Canada*, [2008] F.C.J. 500). In its affidavit, CRA stated that it was concerned by ICAN's participation in donation tax shelters, which had resulted in a significant increase of total revenue during this period — from



The Canada Revenue Agency has a mandate to carefully scrutinize tax shelter schemes involving charities.



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Both decisions highlight compliance issues for all registered charities...

\$528,000 in 2001 to \$314 million in 2005. CRA's concerns also related to the valuation and existence of gifts in kind, which comprised the majority of ICAN's donations, and whether ICAN actually received the goods for which it issued income tax receipts.

In dismissing the application, the court noted that if the suspension were postponed, CRA would be "handcuffed" in its ability to administer the charities provisions of the ITA,

to ensure compliance and to protect the public interest.

This is the first decision with respect to the application of the new intermediate sanctions and the Tax Court of Canada's first foray into the regulation of charities. The decision establishes that, from the Tax Court of Canada's perspective, the test for applications pursuant to subs. 188.2(4) and (5) is the same as that for seeking injunctive relief.

The threshold for the first part of the test — whether a serious issue is to be tried — seems to have been set fairly low and was easily satisfied by the applicant in this instance. The application of the second part of the test — irreparable harm to the charity — indicates that the court will be looking for corroborating evidence from the charity to support any claim of irreparable harm.

Finally, it appears that the third part of the test — balance of convenience — will generally favour CRA, given its role in regulating charities and protecting the public interest. The decision also highlights the importance of maintaining ade-

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New law shields RRSPs from seizure

Recent federal legislation amending the *Bankruptcy and Insolvency Act* (BIA) seems set to make unseizable and exempt from execution all registered retirement savings plans (RRSPs), registered retirement income funds (RRIFs), and other similar registered savings plans, including self-directed plans.

The new rules have not yet come into force, but will do so on proclamation by the federal government. This may occur by the end of 2008 when regulations to the legislation have been drafted.

There is a "look back" provision in these new rules allowing creditors to reverse contributions made to the registered plan up to 12 months prior to the bankruptcy of the plan's owner. The rules would apply across Canada to bankruptcies occurring after the rules come into force. However, provincial laws that might provide greater protection to the owner through exemptions from seizure or execution will continue to apply and have precedence over these new rules.

Existing law

The existing law in most provinces, including Quebec and Ontario, does not usually shield



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self-directed RRSPs from seizure or execution.

Most self-directed RRSPs issued by the major financial institutions are set up through a declaration of trust pursuant to which the owner contributes funds and makes investment decisions relating to an account opened though the financial institution and its captive trust company. In the leading case of *Bank of Nova Scotia v. Thibault*, [2004] 1 S.C.R. 758, the Supreme Court of Canada dismissed the possibility of unseizability in such circumstances.

With respect to purported unseizability of RRSP assets held on trust, the Supreme Court wrote, "The trust argument is, to a certain extent, a mirage. The [property on trust] may not be seized to pay the debts of the settlor or of the beneficiary because the property does not belong to them. However, the patrimonial rights of the beneficiary or of the settlor under the trust contract, like any personal patrimonial right, are seizable."

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Banks should consider redrafting their Quebec forms

RRSP

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Instead, RRSP unseizability in most provinces is limited to particular situations provided for by provincial legislation that do not usually extend to self-directed plans. Typical of this is Quebec, where *Thibault* seems to indicate that RRSP unseizability is limited to situations where the registered assets are used to purchase a true annuity issued by either an insurer or a trust company, and where the beneficiary of that annuity is either designated as irrevocable, or is the owner's spouse or certain other close relatives.

It subsequently has been held, for example, that segregated mutual funds are not an annuity, and are seizable (*Gervais v. Appel & Cie Inc.*, [2005] J.Q. No. 12714 (Q.S.C.)).

The Quebec trust

In *Thibault*, the court also held that although the typical declaration of trust used for many registered plans may indeed be a valid investment-related contract, it is not a trust under Quebec law given the investor's discretionary rights to direct investments and withdraw assets. (No one seems to be suggesting that this declaration of trust is not a trust in the rest of Canada.)

The court based its view on the Quebec civil law of trusts, including Article 1260 of the *Civil Code of Quebec*, requiring trustee control and administration of trust assets.

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Although the typical declaration of trust used for many registered plans may indeed be a... contract, it is not a trust under Quebec law.

Should a Quebec resident be concerned that the standard self-directed savings plan set up by declaration of trust is not a trust for Quebec purposes? Perhaps so, given that subs. 146(1) of the *Federal Income Tax Act (ITA)* appears to provide as a starting point definition that retirement savings plans are set up by way of trusts (and also, it appears, by way of annuities or bank or credit union deposits, which usually are not applicable to self-directed plans).

The federal government has recognized that there may be concerns that since these self-directed plans are not trusts in

Quebec, they therefore might not fit for Quebec purposes within the definition of an RRSP, RRIF or related plan (see Canada Revenue Agency technical interpretation 2005-13332 of

savings plans set up by way of trust, so long as they are entered into prior to 2010, and are set up “under a written contract that is governed by the laws of the Province of Quebec.”

The federal Department of Finance (in explanatory notes of November 2006) believes that the period until 2010 will allow financial institutions with Quebec customers time to assess whether the declarations of trust “may be affected by the *Thibault* decision and, if so, to adjust accordingly.”

This raises concerns regarding self-directed RRSPs and RRIFs in Quebec:

- Although in the past it was usually in no one's interest to challenge the validity of an individual retirement savings plan based on technicalities of trust law, this will not be the case once self-directed plans become unseizable. Hopefully, Bill C-10 (concerning Quebec registered savings plans as trusts) will come into force as soon as pos-

sible, and no later than the coming into force of the BIA amendments concerning unseizability;

- Since the current boilerplate trust forms used by many financial institutions for self-directed plans in Quebec are often stated as being governed by “the laws of the Province of Ontario”, Bill C-10 apparently will require Quebec investors seeking unseizability of those plans to argue that an RRSP or RRIF is a consumer contract (*Quebec Consumer Protection Act*, s.19) which is governed by Quebec law even if the contract says otherwise;

- Financial institutions should consider how to redraft the forms they use in Quebec for self-directed plans, to make the forms compliant with Quebec trust law for plans entered into after 2009. ■

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Prepayment rights a concern

Business

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denied to corporations (or joint stock companies as set out in the *Mortgages Act*).

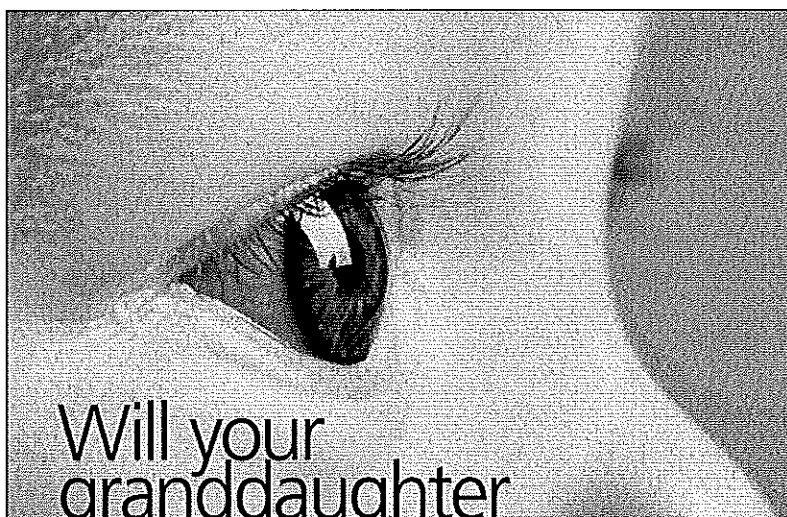
Many income trusts do not have corporate trustees and a mortgage is typically executed by an individual on behalf of individual trustees. While a mortgage may also be given by a bare corporate nominee company, the trustees will also have to execute a full recourse mortgage on behalf of the trust.

There is a question then of whether the trust has a statutory right of prepayment after five years. This will affect any enforceability opinion to be given on behalf of a trust in respect of a mortgage with a term in excess of five years which is not by its terms pre-

payable. The issue is whether the mortgage is in fact enforceable in accordance with its terms since the trustees may be able to prepay under the statutes. In the end it may be an impossible problem to solve and a qualification should state, “We express no opinion with respect to the applicability of the prepayment provisions of the *Mortgages Act (Ontario)* or the *Interest Act (Canada)*.”

Opinions on trusts require more attention and diligence than standard corporate opinions. A careful analysis of the trust declaration and an analysis of trust law must be carried out even in respect of the simplest contracts. ■

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