

CARTERS

BARRISTERS

SOLICITORS

TRADEMARK AGENTS

IMAGINE CANADA
Charity Tax Tools Webinar
October 18, 2011

Donation or Sponsorship?
Know the Rules, Reap the Rewards

By Terrance S. Carter, B.A., LL.B., TEP, Trade-mark Agent

tcarter@carters.ca

1-877-942-0001

© 2011 Carters Professional Corporation

CARTERS PROFESSIONAL CORPORATION
TOLL FREE: 1-877-942-0001

Ottawa Toronto Mississauga Orangeville
www.carters.ca www.charitylaw.ca www.antiterrorismlaw.ca

A. INTRODUCTION

- Corporate support for charities has always been an important source of contribution for the charitable sector and will continue to be so even more given recent cutbacks in government grants
- In addition to the tax benefits available for corporate support of charities (as discussed below), there are other significant benefits:
 - Improved corporate image and reputation, i.e. the “Halo effect”
 - Increased brand awareness and recognition for the corporation
 - Positive consumer purchasing and investment decisions

- Customer loyalty recognition that the corporation is a responsible neighbour
- Improved recruitment and retention of employees
- Improved inter- and intra-company collaboration and sense of purpose
- Boosting of staff morale about corporate image
- The question often faced by corporations, though, in deciding how to support charities is whether the support should be done as a donation or as a sponsorship
- Since a corporation gets a tax benefit either way (i.e. a tax deduction for both donations and sponsorships), there is often a lot of confusion with both corporations and charities concerning which option to follow

- As well, corporations may often ask for a charitable receipt when they may neither need one nor are entitled to one
- Failure to know which option to follow can have negative consequences for both the corporation and the charity
 - For the corporation, CRA can challenge the charitable receipt if it is not properly issued or a business expense can be challenged if the corporation is not entitled to claim it
 - For the charity, CRA can impose monetary penalties, suspension of receipting privileges and even revocation of charitable status if a charitable receipt has been improperly issued

- The answer in dealing with this thorny issue is to know the rules to reap the rewards
- Specifically, in order to reap the benefits of deducting a charitable donation or a sponsorship expense, both the corporation and the charity need to know the tax rules and then together make informed decisions
- This presentation outlines what corporations and charities need to know in this regard:
 - The rules for charitable donations
 - The rules for sponsorship
 - When to donate and when to sponsor
 - A practical approach to follow

B. THE RULES FOR CHARITABLE DONATIONS

1. Different Tax Rules for Different Types of Gifts

a) Regular charitable gifts by corporations

- A corporation may deduct the eligible amount of gifts made to qualified donees (which includes registered charities) in the year of the gift or carried forward from the preceding 5 years (ss. 110.1(1)(a))
- In general, a corporation is entitled to a tax deduction from its taxable income up to a maximum of 75% of its net income, plus 25% of certain taxable capital gains, and 25% of any capital cost recapture (ss. 110.1(1))
- A charitable receipt no longer has a negative impact on disbursement quota calculations (80% DQ) as a result of the 2010 DQ reform

b) Ecological gifts by corporations

- A corporation is entitled to claim a deduction up to 100% of net income of the eligible amount of gift of land (including a covenant or an easement) if all of the following criteria are met (ss.

110.1(1)(d)):

- The land is certified by the Minister of the Environment to be ecologically sensitive land, the conservation and protection of which is important to the preservation of Canada's environmental heritage
- The fair market value of the gift is determined and certified by the Minister of the Environment

- The gift is made by the corporation in the taxation year or in the preceding 5 years to any of the following:
 - The Crown
 - A province or municipality in Canada
 - A municipal or public body performing a function of government in Canada
 - A registered charity established for the conservation and protection of Canada's environmental heritage and that is approved by the Minister of the Environment in respect of the gift
- No capital gains inclusion occurs on the gift, except gifts to private foundations

- c) Gift of certified cultural property by corporations
 - A corporation is entitled to claim a deduction up to 100% of net income of the eligible amount of all gifts of cultural property to an institution or a public authority in Canada that was, at the time the gift was made, designated under the *Cultural Property Export and Import Act* (ss. 110.1(1)(c))
 - Examples would include objects of decorative art, such as ceramics, textiles, furniture, sculptures, etc made in Canada and more than 100 years old
 - The gifts must be determined by the Canadian Cultural Property Export Review Board to have met the applicable criteria for cultural property
 - There is no capital gains inclusion of the gift

2. Rules Relating to Annual Limit of Deductions for Corporations

- Tax deduction can be claimed up to 75% of net income
- Donations can be claimed in the year of the gift or carried forward for up to 5 years
- First-in first-out ordering rule: No amount is deductible until unused deductions from previous taxation years are used first (ss. 110.1(1.1)(b))
- However, deductions cannot be used to create a loss
- As well, the ITA does not permit corporations to sell or transfer unused deductions to other taxpayers (under ss. 110.1(1.2)(a))
 - This ensures that such deductions can't be traded by having a corporation's unused charitable donation deductions treated like capital losses

3. Split-Receipting Rules

a) Meaning of gift

- The traditional common law definition of a gift, which has been adopted by CRA, requires:
 - The donor must have an intention to give
 - Some property is transferred by the donor
 - The transfer of property must be voluntary
 - The gift is made without expectation of return; and
 - No consideration or benefit can be received by the donor

- Proposed draft amendments to the ITA were introduced in 2002 to permit split-receipting
- Although draft amendments have not yet been passed, the amendments are treated by CRA as being administratively in effect according to CRA's Technical News No. 26
- Proposed draft amendments to the *ITA* create a new concept of “gift” for tax purposes, which permits a donor to receive a benefit, provided that the value of the property donated exceeds the benefit received by the donor
- Concept is commonly referred to as “split-receipting”
- The proposed draft amendments on split-receipting reflect an importation of the civil law concept of gift which permits a benefit back to the donor

b) Basic mechanics of split-receipting rules

- Charitable donation receipts must now reflect the following formula:

$$\text{Eligible Amount of Gift} = \text{Fair Market Value of the Property Donated} - \text{Advantage Received by Donor}$$

- i) The gift, minus the advantage, must still constitute a voluntary transfer of property and with a clearly ascertainable value

- ii) Donative intent required
 - Must have a clear donative intent by the donor to benefit the charity
 - Donative intent will generally be presumed if the fair market value of the advantage does not exceed 80% of the value of the gift
 - Note that if the value of the advantage to the donor is greater than 80% of the FMV of the gift, then the registered charity cannot issue a tax receipt unless the donor is able to establish to the satisfaction of the Minister that there was an intention to make a gift

iii) Deduct Advantage

– Broad definition of advantage includes:

- the total value of all property, services, compensation, use or other benefits,
- to which the donor, or a person not dealing at arms length with the donor,
- has received or obtained or is entitled to receive (either immediately or in the future),
- as partial consideration of or in gratitude of the gift or that is in any other way related to the gift

- The advantage must be clearly identified and its value must be “ascertainable,” otherwise no tax deduction or credit will be allowed
- Value of advantage is the total value of any “property, service, compensation, use or other benefit” in question
- Timing of valuation is the time when the gift is made
- The advantage can be received prior to, at the same time as, or subsequent to the making of the gift
- The advantage does not require a causal relationship between the making of the gift and the receiving of the advantage, as long as the advantage is in some way related to the gift

- The advantage can be provided to the donor or to a person or partnership not dealing at arm's length with the donor
- It is not necessary that the advantage be received from the charity that received the gift, i.e. the advantage could be provided by third parties unbeknownst to the charity
- CRA's *de minimus* rule creates an exception
 - Applies where there is a token advantage of the lesser of 10% of the value of the gift and \$75
 - Such minimal advantage does not need to be deducted from the value of gifts when issuing receipts
 - However, this rule does not apply to cash or near cash equivalents

- CRA's Technical News No. 26 covers what to do in particular situations and fundraising events that may not have a readily available market value comparison of the advantage or inducement provided to the donor
 - Fundraising dinners
 - Charity auctions
 - Lotteries
 - Concerts, shows and sporting events
 - Golf tournaments
 - Membership fees
 - Charitable annuities
 - Mortgaged property

- Examples of the extent of an “advantage”
 - A charity receives a gift of land from a donor who is to receive a discount on a building lot from a developer who owns property adjacent to the donated property in exchange for making the gift
 - A donor poses for pictures with his wife, a professional model, after agreeing to make a large donation to a charity and the agreement regarding the donation is publicized with various media outlets publishing the pictures, resulting in the wife of the donor receiving increased modeling work

- Naming rights
 - Naming rights by an individual or corporation are not advantages if there is “no prospective economic benefit” associated with the naming rights
 - Corporate donors
 - A simple “thank you” business name recognition along with all other donors does not constitute an advantage
 - However, if a corporation wishes to make a donation in exchange for the promotion of its business name (which would include a related personal name), an economic benefit may result in creating an advantage that, if reasonably ascertainable in value, must be deducted from the gift in calculating the eligible amount of the gift

- iv) The “deemed fair market value” rules
 - The proposed “deemed fair market value” rules for a gift of property are the result of the government’s attempt to curtail abusive tax shelter donation schemes by severely restricting the tax benefits from donations made under these schemes
 - However, the deemed fair market value provisions do not apply to inventory, real property or an immovable situated in Canada, certified cultural property, publicly traded shares and ecological gifts

- FMV of donated property will be deemed to be the lesser of
 - The fair market value of the property and
 - The cost (or the adjusted cost base where applicable) of the property to the tax-payer immediately before the gift is madein the following three situations:
 1. If the donor acquired the property through a “gifting arrangement” i.e. a donation tax shelter scheme;
 2. If the donor acquired the property less than 3 years before making the gift; or

3. If the donor acquired the property less than 10 years before making the gift, if it was reasonable to conclude that when the donor acquired the property, one of the main reasons for the acquisition was to make a gift (donor must prove that the donor did not have an expectation to make a gift when the property was acquired)
 - Amendments to this provision also require a “look-back” to see if the property had been acquired within the last 10 years by a non arm’s length person and if so then the “deemed fair market value” applies when that non arm’s length person acquired the property

- *Richert v Stewards' Charitable Foundation* (2005) confirmed split-receipting rules
 - Richert donated \$1000 for which he received a luncheon and a book and a receipt for \$855
 - In calculating the amount for the receipt, Stewards' divided the donation into an eligible amount of \$855 and an advantage of \$145 for the luncheon and book in order to comply with CRA's Technical News No. 26 specifically applying to "fundraising dinners"
 - Richert challenged the applicability of the guidelines
 - BC Supreme Court upheld compliance with the Guidelines, despite that the provisions of the ITA have not yet been enacted as law (confirmed on appeal)

C. THE RULES FOR SPONSORSHIP

1. The Meaning of “Sponsorship”

- “Sponsorship” is not defined in the ITA
- However, CRA generally takes the position that sponsorship is a contribution made by a business to a charity which in return receives advertising or promotion of its brand, products or services
- CRA takes the view that sponsorship fees are not gifts and charitable receipts cannot be issued for sponsorship fees because the sponsor receives something in exchange and they are usually paid to support a charity event in return for advertising or other type of consideration

2. The Tax Treatment of Sponsorship Payment

- A corporation may deduct 100% of a sponsorship fee as a business expense under section 18 of the ITA within the immediate fiscal year, provided that such payment generally meets six tests
 - The expense is of an income nature and not a capital expenditure
 - The expense is reasonable in amount
 - The expense is incurred for the purpose of earning income
 - The expense is not a personal expenditure
 - The expense is not expressly prohibited by the ITA
 - The expense does not constitute an “abusive tax avoidance”

- What is a reasonable amount is a question of fact by comparing the expense in question with amounts paid in similar circumstances in comparable businesses
- For example, if a business received special recognition as a donor in a charity's monthly newsletters that is widely distributed in appreciation of a contribution made by the business, then the business claiming such contribution as an expense may need to determine what a similar advertisement in a publication with similar circulation would cost in order to ensure that the amount of the contribution is reasonable

D. WHEN TO DONATE AND WHEN TO SPONSOR

1. Overview Comparison Between Charitable Donations and Sponsorship

Charitable donation	Sponsorship fee
Tax deduction for corporation	Business expense for corporation
A corporation may deduct the eligible amount of a gift up to 75% of net income, plus 25% of certain taxable capital gains, and 25% of any capital cost recapture	A corporation may deduct 100% of a sponsorship fee as a business expense under section 18 of the ITA
A charitable tax deduction can be carried forward for up to five years	A sponsorship fee must usually be deducted within the fiscal year in which it was made
Charitable receipt will no longer have any negative impact on disbursement quota calculation (It used to have an impact before DQ reform)	A sponsorship fee never had any negative impact on disbursement quota calculation

2. How to Evaluate Between Donations, Sponsorship or a Mix of the Two
 - When a corporation makes a contribution to a charity, it could be any of the following:
 - 100% charitable donation
 - 100% sponsorship contribution
 - Partly charitable donation and partly sponsorship – which is now possible because of split-receipting guidelines
 - a) Scenario 1 - 100% charitable donation
 - This can occur in two situations:
 - i) Where a corporation receives no advantage in return for having made a gift

- ii) It is also possible that the corporation receives some advantage which is not material in nature and the amount of the advantage received is below CRA's *de minimis* threshold of the lesser of \$75 or 10% of the value of the donated property
 - e.g. The recipient charity provides the corporate donor with a small appreciation gift or a simple thank you acknowledgement of the gift in its annual report along with all other donors, or other minor name recognition
- In both situations, the recipient charity would be able to issue a charitable receipt for 100% of the gift as the eligible amount

- b) Scenario 2 - 100% sponsorship contribution
 - This can occur in three situations
 - i) Where a corporation makes a contribution to a charity and the corporation receives an advantage that is *so material* in nature that the advantage received is attributable to the entire value of the contribution made
 - ii) When the value of the advantage is not “ascertainable” and therefore no charitable receipt can be issued

- iii) Where the advantage received by the corporation exceeds 80% of the contribution made but the corporation was not able to prove to CRA that it has the intention to donate the property to rebut the statutory presumption of lack of intent to give
 - In any of these three situations, the corporation would be entitled to write off 100% of the contribution and claim a business expense for advertising, marketing or promotion
 - Similarly, the charity would not need to, nor could issue a charitable receipt

- c) Scenario 3 – Some advantage received – resulting in split-receipting
 - This occurs where a corporation receives an advantage that is above the *de minimis* threshold as a result of having made a gift to a registered charity but the amount of the advantage does not exceed 80% of the fair market value of the gift
 - The charity would need to assess the amount of the advantage received and issue a split-receipt to the corporate donor for the eligible amount, which could then be claimed as a charitable deduction
 - The corporation would also be entitled to deduct the non-receipted portion of the contribution as a business expense
 - However, cannot double up in claiming deductions

- CRA has been developing a policy concerning whether certain types of contributions are sponsorship or donation in order to assist charities
- CRA is continuing to seek input from the sector in developing its Summary Policy on *Sponsorship CSP-S13*, currently under revision
- Most recent communication to the sector on this topic is *Charities Connection No. 8 – August 2011* on hole sponsorship at a golf tournament
- While this newsletter was provided in the context of golf tournaments, the principles are the same for any sponsorship, e.g. in order to issue a receipt, the value of the advantage must be calculated and be ascertainable in order to determine the eligible amount

- Questions/comments to CRA can be directed to 1-800-267-2384 or consultation-policy-politique@cra-arc.gc.ca
- The policy, once prepared, will include clarification concerning when charities are offered corporate donations that contain mixed elements of sponsorship and charitable gift
- From the above review, it is clear that there is no disadvantage to charities in whether they receive a donation or a sponsorship
- It is only when issuing receipts that charities could get into trouble for issuing incorrect amounts that are not in accordance with the ITA, thus triggering sanctions by CRA (as per sections 188.1 and 188.2(1))
- Charities in particular, therefore, need to be careful

E. A PRACTICAL APPROACH TO FOLLOW

- Both corporations and charities need to know the tax rules and develop appropriate policies
- For charities, they should consider developing:
 - a) A gift acceptance policy that would include
 - Guidelines and due diligence practices for corporate donations v. sponsorship,
 - An explanation of split-receipting rules
 - b) A corporate sponsorship policy setting out the parameters for accepting sponsorship, such as
 - The term of sponsorship,
 - The extent of sponsorship,
 - Reporting of sponsorship,
 - Termination of sponsorship, and
 - Protection of intellectual property

- c) A sponsorship agreement template that would reflect the said parameters for sponsorship and would include specific provisions addressing terms for reciprocal licensing of intellectual property matters, including trade-marks and copyright, such as
- Ownership of intellectual property and appropriate warranties
 - Limits on use of intellectual property
 - Reporting requirements
 - Termination of licensing of intellectual property

- For corporations, they should also consider developing on a reciprocal basis:
 - a) a corporate gift acceptance policy;
 - b) a corporate sponsorship policy; and
 - c) a corporate sponsorship written agreement template, including terms and conditions of such arrangement
- There should be open dialogue between the charity and the corporation in order that there can be a mutual agreement concerning how to record corporate contributions to the charity
- Together, if the charity and the corporation play by the rules, they can collectively “reap the rewards”

CARTERS

BARRISTERS

SOLICITORS

TRADEMARK AGENTS

Disclaimer

This handout is provided as an information service by Carters Professional Corporation. It is current only as of the date of the handout and does not reflect subsequent changes in the law. This handout is distributed with the understanding that it does not constitute legal advice or establish a solicitor/client relationship by way of any information contained herein. The contents are intended for general information purposes only and under no circumstances can be relied upon for legal decision-making. Readers are advised to consult with a qualified lawyer and obtain a written opinion concerning the specifics of their particular situation.

© 2011 Carters Professional Corporation

CARTERS PROFESSIONAL CORPORATION
TOLL FREE: 1-877-942-0001

Ottawa Toronto Mississauga Orangeville
www.carters.ca www.charitylaw.ca www.antiterrorismlaw.ca