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Donation or Sponsorship? Know the Rules, Reap the Rewards

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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 in the future given government cut backs
- 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
 - 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
- 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 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
- 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
 - Related rules for special types of gifts
 - A practical approach to follow

B. THE RULES FOR CHARITABLE DONATIONS

1. Different Tax Rules for Different Types of Gifts

a) Regular charitable gifts

- A corporation may deduct the eligible amount of gifts made to qualified donees (which includes registered charities) in the year of the gift or in the preceding 5 years
- 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
- A charitable receipt no longer has a negative impact on disbursement quota calculations as a result of the 2010 disbursement quota reform

b) Ecological gifts

- A corporation is entitled to claim 100% deduction of the eligible amount of gift of land (including a covenant or an easement) if all of the following criteria are met:
 - The fair market value of the gift is determined and certified by the Minister of the Environment
 - 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 gift is made by the corporation in the taxation year or in the preceding 5 preceding years to any of the following:
 - The Crown
 - A 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 environment heritage and that is approved by the Minister of the Environment in respect of the gift

c) Gift of certified cultural property

- A corporation is entitled to claim 100% deduction 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*
- The gifts must be determined by the Canadian Cultural Property Export Review Board to have met the applicable criteria for cultural property
- The applicable rules apply to gifts in the taxation year and gifts made in the preceding 5 preceding years

2. Rules Relating to Annual Limit of Deductions for Corporations

- Donations can be claimed in the year of the gift or in the preceding five years
- First-in first-out ordering rule applies whereby no gifts are deducted until amounts deductible for those gifts made in preceding taxation years have been deducted
- Corporations may carry forward unused charitable donation deductions for up to five years – However, in respect of gifts made after March 22, 2004, the ITA does not permit corporations to sell or transfer these unused claims to other taxpayers

3. Split-Receipting Rules

a) Meaning of gift

- The traditional common law definition of a gift requires:
 - The donor must have an intention to give
 - There must be a transfer of property
 - The transfer must be made voluntarily without contractual obligation; and
 - No consideration or advantage 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, they are treated by CRA as being administratively in effect
- 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) Mechanics of split-receipting rules

- Charitable donation receipts must now reflect the following formula:

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

- i) Must be voluntary transfer of property 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

iii) Deduct Advantage

– Broad definition - 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 donation receipt can be issued
- 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
- Does not require a causal relationship between the making of the gift and the receiving of the advantage, as long as the advantage is 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 administrative exemption applies where there is a token advantage of the lesser of 10% of the value of the gift and \$75 (*de minimis* threshold)

– Examples

- A charity receives a gift of land from a donor who has received some type of benefit from a developer who owns property adjacent to the donated property in exchange for making the gift
- A donor who poses for pictures with his wife, a professional model, after agreeing to make a large donation to a charity. The agreement regarding the donation is publicized, various media outlets publish the pictures, and the wife of the donor receives increased modeling work as a result

- 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
 - If a corporation wishes to make a donation in exchange for the promotion of its business name (or related personal name), an economic benefit will result in creating an advantage that if ascertainable in value must be deducted from the gift in calculating the eligible amount of the gift
 - However, a simple “thank you” business name recognition along with all other donors does not constitute an advantage

- iv) The “deemed fair market value” rules
 - The proposed “deemed fair market value” rules for a gift 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
 - 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 made
- in 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
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)

- New provision also requires a “look-back” to see if the property had been acquired within the 3 or 10 years by a non arm’s length person and if so then the “deemed fair market value” applies to the person
- The deeming provision does not apply to inventory, real property or an immovable situated in Canada, certified cultural property, publicly traded shares and ecological gifts

C. THE RULES FOR SPONSORSHIP

1. The Meaning of “Sponsorship”

- “Sponsorship” is not defined in the ITA
- However, CRA has stated that sponsorship is a donation 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 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 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 may need to determine what a similar advertisement in a publication with similar circulation would cost in order to ensure that the amount is reasonable

D. WHEN TO DONATE AND WHEN TO SPONSOR

1. Overview Comparison Between Charitable Donations and Sponsorship

| Charitable donation | Sponsorship fee |
|---|--|
| 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 expenses under section 18 of the ITA |
| A charitable tax deduction can be carried forward for a period of 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 impact on disbursement quota calculation (It used to have an impact before DQ reform) | No 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
 - 100% charitable donation
 - 100% sponsorship
 - Partly charitable donation and partly sponsorship – which is possible because of the new split-receipting rules
 - a) Scenario 1 - 100% charitable donation
 - Where a corporation receives no benefit in return for having made a gift

- 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 one-line acknowledgement of the gift in its annual report along with all other donors
- In either situation, 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
 - 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 should issue a charitable receipt

- c) Scenario 3 – Some advantage received – resulting in split-receipting
- Where a corporation receives some benefits that is above the *de minimis* threshold as a result of having made a gift to a registered charity but the amount of contribution made 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

- CRA has been in the development stage of a policy for some time concerning whether certain types of contributions are sponsorship or donation in order to assist charities
- CRA is seeking input from the sector (Canada Revenue Agency, *Registered Charities Newsletter* No. 22, March 2005)
- The policy, once prepared, will include clarification concerning when charities are offered corporate donations that contain mixed elements of sponsorship and charitable gift

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 for corporate donations v. sponsorship, including split-receipting rules;
 - b) a corporate sponsorship policy setting out the perimeters for accepting sponsorship; and
 - c) a sponsorship agreement template that would include provisions addressing terms for reciprocal licensing of intellectual property matters, including trade-marks and copyright

- For corporations, they should also consider developing:
 - a) a corporate gift acceptance policy;
 - b) a corporate sponsorship policy; and
 - c) a corporate sponsorship agreement template
- Then there needs to develop an 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”

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