

A review of draft amendments to the Income Tax Act

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On September 16, 2004, the Department of Finance released draft amendments (the "Amendments") to the *Income Tax Act* that will implement new rules concerning the taxation and administration of charities set out in the March 23, 2004 Federal Budget (the "Budget").

Details regarding the Budget and proposed amendments to the Act are summarized in *Charity Law Bulletin* No. 41, 54, 55, 56 and 59 at www.charitylaw.ca. The Amendments generally apply to taxation years beginning after March 22, 2004, with some exceptions being in effect after the later of December 31, 2004 and 30 days after Royal Assent.

New intermediate sanctions

To provide an alternative to revocation of charitable status for minor or unintended infractions, the Amendments introduce intermediate sanctions. These sanctions include taxation of gross revenue derived from business activities, suspension of tax-receiving privileges, monetary penalties, and taxation of gifts and transfers to other registered charities.

Some sanctions are progressive, increasing in severity for repeat infractions within a period of 10 years.

Annulment and revocation

The Amendments provide the Minister with explicit authority to annul an organization's registration if it was registered in error or if it has ceased to be a charity "solely as a result of a change in law."

Annulled organizations will be deemed not to have been registered at all and the Part V revocation tax will not apply, but official receipts issued prior to annulment will be accepted as valid.

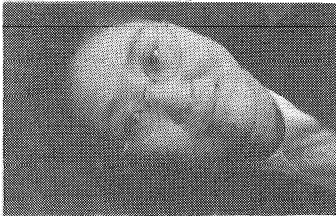
The Minister retains the right to revoke the registration of a charity in the event of severe breaches of the Act. The amendments also require the assets of a charity whose registration has been revoked be transferred to "eligible donees", rather than to the full list of qualified donees.

Appeals

The Amendments propose to make the appeal process more accessible and affordable for registered charities and unsuccessful applicants for charitable status. Canada Revenue Agency's ("CRA") internal review process is proposed to be extended to notices of a decision by the Minister regarding the revocation or annulment of a charity's registration, designation of a charity as a private or public foundation or



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special status or an exemption under the Act (e.g. request for permission to accumulate assets); and reasons for denying the registration of organizations.

Further, official donation receipts issued after 2004 will be required to include the current internet address of CRA.

RRIFs and RRSFs as a result of direct beneficiary designation), 10-year gifts received by the charity, and gifts received by the charity as the transferee of an enduring property.

A charity will be permitted to encroach on the capital gains of enduring property up to a maximum of the "capital gains pool" of the charity, which is the realized capital gain from the disposition of enduring property.

This means that the requirement to disburse 80 per cent of the amount of an enduring property expended in the year is extended to enduring property received by way of gift in the same year, but this requirement is reduced by the lesser of 3.5 per cent of the investment assets of the charity and 80 per cent of the "capital gains pool" of the charity.

Transfers from registered charities to charitable organizations were previously exempt from the 80 per cent disbursement quota.

The Amendments propose that all transfers from one registered charity to another will be subject to the 80-per-cent disbursement requirement, except those involving specified gifts and enduring property.

Although many aspects of the proposed new rules reflect an attempt by the Department of

New disbursement quota rules

The Amendments propose to reduce the 4.5 per cent disbursement quota that applies to public and private foundations to a more manageable rate of 3.5 per cent. The disbursement quota reduction applies to taxation years that begin after March 22, 2004.

Only public and private foundations have previously been subject to a disbursement quota on capital assets not used in charitable activities or administration. However, the Amendments propose that the reduced 3.5 per cent disbursement quota also apply to charitable organizations. It is anticipated that further amendments will be forthcoming to exempt smaller charities from disbursement quota.

A new concept of "enduring property" was introduced, which includes gifts received by way of a bequest or inheritance (including gifts of life insurance proceeds,

charitable organization, denial of applications for charitable status, or imposition of taxes or penalties against a registered charity. Appeals of decisions concerning refusals to grant registered charitable status and revocation of registered charitable status will continue to be made to the Federal Court of Appeal, while taxes and penalties will be appealed to the Tax Court of Canada.

Transparency & accessibility of information

The Amendments propose to authorize the Minister to release to the public additional information, including grounds for revocation or annulment; financial statements; decisions of CRA regarding notices of objection; identification of the registered charity which is subject to a sanction, the type of sanction imposed, and grounds for the sanction; information to support an application by a registered charity for

Charities in Finance sites

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Finance to address a number of problems facing charities involving the disbursement quota, the complexities introduced by the new disbursement quota rules are such as to make them difficult, if not impossible, for the average charity to understand, let alone comply with.

In addition, there are concerns about the application of the proposed 3.5-per-cent disbursement quota being extended from charitable foundations to charitable organizations and the exemption of transfers of capital to charitable organizations from other registered charities being removed.

This represents a major change in tax policy by the Department of Finance that will blur the line

between public foundations and charitable organizations to the point that the need for public foundations may be eliminated, leaving only charitable organizations and private foundations.

** This article was written prior to the release of a Notice of Ways and Means Motion by the Minister of Finance on December 6, 2004, and does not reflect any changes introduced by that document.*

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