CANADIAN ASSOCIATION OF GIFT PLANNERS
12th Annual National Conference

APRIL 14, 2005
(Current to March 16, 2005)

RECENT INCOME TAX AMENDMENTS AFFECTING CHARITIES AND GIFT PLANNING

By Terrance S. Carter, B.A., LL.B. and Trade-mark Agent,
and Theresa L.M. Man, B.Sc., M.Mus., LL.B.

CARTERS.ca™
CARTER & ASSOCIATES
PROFESSIONAL CORPORATION
BARRISTERS, SOLICITORS & TRADE-MARK AGENTS
Affiliated with Fasken Martineau DuMoulin LLP

Main Office Location
211 Broadway, P.O. Box 440
Orangeville, ON, Canada, L9W 1K4
Tel: (519) 942-0001
Fax: (519) 942-0300
Toll Free: 1-877-942-0001
www.carters.ca™

National Meeting Locations
Toronto (416) 675-3766
Ottawa (613) 212-2213
London (519) 937-2333
Vancouver (877) 942-0001
"Proactive Advice" ®
www.charitylaw.ca™

RECENT INCOME TAX AMENDMENTS AFFECTING CHARITIES AND GIFT PLANNING

By Terrance S. Carter, B.A., LL.B. and Trade-mark Agent, and
Theresa L.M. Man, B.Sc., M. Mus., LL.B.

April 14, 2005
(current to March 16, 2005)

TABLE OF CONTENTS

RECENT INCOME TAX AMENDMENTS AFFECTING CHARITIES AND GIFT PLANNING

By Terrance S. Carter,* * *B.A., LL.B. and Trade-mark Agent, and
Theresa L.M. Man,* * *B.Sc., M. Mus., LL.B.

April 14, 2005
(current to March 16, 2005)

A. INTRODUCTION

This paper is intended to provide an overview of recent legislative reform proposed under the *Income Tax Act* (the "Act")[1], including provisions curtailing tax shelter donation schemes, as well as changes to enact the intermediate sanction rules, restrictions on trading charitable donations, a new appeals regime and revisions to the calculation of the disbursement quota that applies to gifts received by registered charities.

Since December 2002, the Department of Finance and Canada Revenue Agency ("CRA") have released a series of proposed changes to the Act that affect charities. These proposed changes include the following:

a) Draft Technical Amendments to the Act were released on December 20, 2002 (the "December 2002 Amendments").[2]

b) Income Tax Technical News No. 26 was released on December 24, 2002 ("Technical News No. 26") in relation to new guidelines on split-receipting.[3]

c) The 2003 Federal Budget was released on February 28, 2003 (the "February 2003 Budget"), which expanded the definition of "tax shelter" to include "gifting

---

* Terrance S. Carter, B.A., LL.B., practices law at Carter & Associates, is counsel to Fasken Martineau DuMoulin LLP and is a member of Canada Revenue Agency's Charities Advisory Committee and Technical Issues Committee, e-mail tcarter@carters.ca.

* Theresa L.M. Man, B.A., LL. B., practices law at Carter & Associates, with an emphasis on tax law issues for charities, e-mail tman@carters.ca.

[1] R.S.C. 1985, c. 1 (5th Supp.).

[2] Details regarding the December 2002 Amendments have been summarized in *Charity Law Bulletin* No. 21 dated April 30, 2003, available at www.charitylaw.ca.

[3] Details regarding the Technical News No. 26 have been summarized in *Charity Law Bulletin* No. 23 dated July 31, 2003, available at www.charitylaw.ca.

arrangements." The proposals announced in the February 2003 Budget were introduced into the House of Commons by Bill-C28: *An Act to implement certain provisions of the budget tabled in Parliament on February 18, 2003*, which was passed into law on June 19, 2003.[4]

d) Further amendments to the Act were released at 6:00 p.m. on December 5, 2003 (the "December 2003 Amendments") that will have the effect of curtailing tax shelter donation programs involving the donation of property, restricting the use of limited-recourse debts as tax shelters, and further amending proposals put forward in the December 2002 Amendments.[5]

e) The December 2002 Amendments and the December 2003 Amendments were further amended and consolidated in the revised draft technical amendments released by the Minister of Finance on February 27, 2004 (the "February 2004 Amendments").[6] The February 2004 Amendments have received first reading in the House of Commons,[7] but have yet to be enacted.

f) The Department of Finance released the Federal 2004 Budget on March 23, 2004, (the "March 2004 Budget").[8]

g) Draft amendments to the Act were released on September 16, 2004, (the "September 2004 Amendments") to implement the changes announced in the March 2004 Budget.[9]

h) Lastly, the September 2004 Amendments were further amended by a *Notice of Ways and Means Motion* tabled by the Minister of Finance in the House of Commons on December 6, 2004 ("December 2004 Amendments"). As a result, Bill C-33, *A Second Act to Implement Certain Provisions of the Budget Tabled in Parliament on March 23, 2004* was passed by Parliament on February 25, 2005, and received its first reading by the Senate on March 7, 2005.[10]

---

[4] The portion of the 2003 Budget concerning tax shelter donation schemes involving donors donating property to charities at a value in excess of the donors' acquisition cost was briefly commented upon in *Charity Law Bulletin* No. 30 dated December 16, 2003, available at www.charitylaw.ca.

[5] Details regarding the December 2003 Amendments have been summarized in *Charity Law Bulletin* No. 38 dated February 19, 2004, available at www.charitylaw.ca.

[6] Copies of the Legislative Proposals, Draft Regulations and Explanatory notes are available at: http://www.fin.gc.ca/toce/2004/ita04-introe.html and have been summarized in *Charity Law Bulletin* No. 40 dated March 29, 2004, available at www.charitylaw.ca.

[7] Bill C-69.

[8] Details regarding the March 2004 Budget have been summarized in *Charity Law Bulletin* No. 41 dated March 30, 2004, available at www.charitylaw.ca.

[9] Details regarding the September 2004 Amendments have been summarized in *Charity Law Bulletins* No. 54, 55, 56, and 59, available at www.charitylaw.ca.

[10] Details regarding the December 2004 Amendments have been summarized in *Charity Law Bulletin* No. 61 dated January 12, 2005, available at www.charitylaw.ca.

What follows is an overview of some of the more important aspects of these changes to the Act proposed since December 2003.

B. CURTAILING TAX SHELTER DONATION SCHEMES INVOLVING DONATION OF PROPERTY

On December 5, 2003, at 6 p.m., the December 2003 Amendments were announced by the then Deputy Prime Minister and Minister of Finance, having the effect of limiting tax benefits from charitable donations made under tax shelter donation arrangements. The Department of Finance was taking steps to curtail the scope of tax shelter donation arrangements after receiving public complaints and concerns with respect to donation promoters selling the "buy-low, donate-high" schemes that often provide the donor exceptionally high tax-benefits. The Department of Finance, like CRA, was concerned that the government was losing substantial amounts of tax dollars when the taxpayer/donor was able to claim higher tax deductions than he/she was otherwise entitled to.

1. Limiting tax shelter donation schemes involving donation of property

The February 2003 Budget expanded the definition of "tax shelter" in subsection 237.1(1) of the Act to apply to property acquired by a person under a gifting arrangement in respect of which it is represented that the acquisition of the property would generate any combination of tax credits or deductions that in total would equal or exceed the cost of acquiring the property in question, and that the property acquired will be the subject of a gift to a qualified donee or of a political contribution. The December 2003 Amendments proposed to insert a new subsection 248(35) in the Act, of which subparagraph (a) provides that if the taxpayer acquires the property through a "gifting arrangement," then the fair market value of the property donated, for purposes of the charitable donation receipt issued by the receipting charities, shall be "deemed" to be the lesser of (i) the "fair market value of the property otherwise determined" and (ii) the cost (or the adjusted cost base in the case of capital property) of the property "to the taxpayer immediately before the gift is made" (the "Deeming Provision"). As such, it is irrelevant when the property was acquired by the donor through the gifting arrangement. Subsection 248 (36) states that the Deeming Provision in paragraph 248(35)(a) does not apply to inventory, real property situated in Canada, certified cultural property, publicly traded shares or ecological gifts. Paragraph 248 (35)(a) applies to gifts made on or after 6 p.m., December 5, 2003. The wording of paragraph 248(35)(a) introduced by the

December 2003 Amendments was brought forward and included in the February 2004 Amendments.

2. Other applications of the deeming provision

In introducing the Deeming Provision for donation of property acquired through gifting arrangements, the Department of Finance went further than simply curtailing the tax shelter donation schemes addressed by paragraph 248(35)(a). The Department of Finance further introduced paragraph 248(35)(b) to provide that the Deeming Provision also applies to donation of property under two other situations, namely, (1) pursuant to subparagraph 248(35)(b)(i), if the property was acquired by the donor less than three years before the day that the gift is made, and (2) pursuant to subparagraph 248(35)(b)(ii), if it is "reasonable to conclude that, at the time the taxpayer acquired the property, the taxpayer expected to make a gift of the property." Under the former scenario, if a donor acquires property and donates the property within three years from the date of acquisition, then the fair market value of the property shall be deemed to be the donor's cost or adjusted cost base. Under the latter scenario, regardless of when the donor acquired the property (even outside of the three-year limitation period), as long as it is "reasonable to conclude" that the donor had the intention to make a gift at the time when the property was acquired, then the Deeming Provision would apply. The burden is on the donor to prove that he or she did not have an intention to make a gift when the property was acquired.

Pursuant to subsection 248(36), paragraph 248(35)(b) does not apply to inventory, real property situated in Canada, certified cultural property, publicly traded shares, or ecological gifts. As well, the opening wording of paragraph 248(35)(b) provides that the Deeming Provision does not apply to situations where the gift is made as a consequence of the donor's death. Paragraph 248(35)(b) applies to gifts made on or after 6 p.m. on December 5, 2003.

3. Restricting the use of tax shelter donations involving limited recourse debt

In addition to the donation of property to charities under the gifting arrangements of tax shelter donation schemes, another type of gifting arrangement which the Department of Finance felt the need to restrict involves limited-recourse debts incurred by donors (also known as "leveraged loans" or "leveraged donation shelters"). This usually involves a donor borrowing monies from a lender, followed by the donor donating the borrowed fund together with some of his or her own funds to a charity in return for a charitable donation receipt for the cumulative amount donated. At the same time, the donor pays a fee or other charges to the promoter, which fee or charges would be used to purchase property or to be invested for a return that would, over the term of the loan, be sufficient to pay off the loan borrowed.

The February 2003 Budget also expanded the definition of "tax shelter" to include a gifting arrangement under which it may reasonably be expected, having regard to representations made, that if a taxpayer makes a gift or contribution under the arrangement, a person (whether or not it is the taxpayer himself or herself) will incur an indebtedness in respect of which recourse is limited. The December 2003 Amendments propose to curtail the use of these arrangements by introducing a series of amendments to the Act, including the insertion of new subsection 143.2(6.1) to the Act, the amendment of the wording of subsection 143.2(13) before paragraph (a), the insertion of new paragraph (b) to subsection 248(31) that was introduced by the December 2002 Amendments[11], as well as the insertion of new subsection 248(34). These amendments apply to donations made after February 18, 2003, and have been included, unchanged, in the February 2004 Amendments, save and except minor wording changes in subsections 143.2(6.1) and 248(34). A summary of the amendments follows.

The proposed paragraph 248(31)(b) of the Act provides that the amount of gift made by the donor would be reduced by the amount of the limited-recourse debt incurred as determined pursuant to the newly proposed subsection 143.2(6.1). Subsection 143.2(6.1) of the Act introduces a new definition of "limited-recourse debt" which has two aspects. Firstly, pursuant to paragraphs 143.2(6.1)(a) and (b), a "limited-recourse debt" is a limited-recourse amount, which is defined under section 143.2(1) to mean "the unpaid balance of any indebtedness for which recourse is limited, either immediately or in the future and either absolutely or contingently," that can "reasonably be considered to relate to the gift." In situations where recourse is not limited, the debt may be "deemed" to be a limited-recourse debt under the current subsection 143.2(7) of the Act unless there are bona fide arrangements in writing to repay the debt within 10 years, and interest is paid annually, within 60 days after the debtor's taxation year, at not less than CRA's prescribed rate. Secondly, pursuant to paragraph 143.2(6.1)(c), a "limited-recourse debt" means any indebtedness, whether or not

[11] See *Charity Law Bulletin* No. 21 dated April 30, 2003 *available at* www.charitylaw.ca.

recourse is limited, that can "reasonably be considered to relate to the gift", for which there is a "guarantee, security or similar indemnity or covenant" in respect to that debt or any other debts.

The cumulative effect of the paragraph 248(31)(b) and subsection 143.2(6.1) is to reduce the amount of the gift made by the donor by the amount of the loan borrowed if the indebtedness is of limited recourse to the lender or if there is a "guarantee, security or similar indemnity or covenant" in respect to that debt or any other debts. The December 2003 Amendments also proposed the addition of subsection 248(34) to the Act that would deem repayments of the limited-recourse debt as gifts in the year it is repaid. Lastly, subsection 143.1(13) is amended so that it is applicable to gifts and monetary contributions by including references to "gift or monetary contribution" in this subsection.

4. <u>Anti-avoidance rule</u>

The December 2003 Amendments also introduced an anti-avoidance rule in the new subsection 248(37) of the *Act*, which states that if "one of the reasons for a series of transactions" that includes a disposition or acquisition of property of a donor is to increase the amount that would be deemed to be the fair market value of the gift under subsection 248(35), then the cost of the property for the purpose of subsection 248(35) shall be deemed to be the lowest cost to the donor to acquire the property in question or "an identical property at any time." This subsection applies to gifts made on or after 6 p.m. on December 5, 2003.

5. <u>Practical implication of recent amendments</u>

The application of the proposed Deeming Provision to gifts made outside of tax shelter donation arrangements under paragraph 248(35)(b)(i) of the Act, if the February 2004 Amendments, which incorporated changes introduced by the December 2003 Amendments, are passed will have serious practical implications on how charities will need to operate in terms of acceptance of gifts and the issuance of charitable donation receipts.

Firstly, charities will be required to inquire of donors of gifts-in-kind when the property donated was acquired by the donors. Where possible, a written confirmation will need to be obtained from the donors in this regard to evidence the date of acquisition. Where property was acquired by the donors less than three years before the date of donation, the charitable donation receipt will need to reflect the deemed fair market value of the property, being the lesser of the appraised fair market value and the cost of acquisition by the donor. Where property was acquired by the donors more than three years before the date of the donation, then the charitable donation receipt will need to reflect the appraised fair market value of the property.

Secondly, where the Deeming Provision applies, then the charity will need to inquire of the donor to determine the amount of the adjusted cost base of the gifted property, where applicable. From a practical standpoint, this would be a difficult if not impossible task for many charities to undertake, particularly smaller charities.

Thirdly, although the burden is on the donors to prove the lack of intention to make a gift when the property was acquired, it raises a concern whether charities will be required to inquire of donors of gifts-in-kind to determine whether the donor had the intention to make a gift at the time when the donor acquired the property, regardless of when the property was acquired. On the one hand, without charities making the necessary inquiries, it is unclear what value should be reflected in the charitable donation receipt that the charities are required to issue to the donor. On the other hand, since charities are obviously grateful to receive donations, it will be difficult for charities to make such inquiries of its donors regarding whether they had any intention to make a gift when the property was acquired.

Fourthly, there is the possibility that the Deeming Provision could lead to unintended negative results, such as catching the donation of privately held shares where the donor exchanged the original shares for shares of another class for the purpose of donating them to a charity. As such, hopefully the wording of the Deeming Provision will be amended before being passed into law to address any unintended results.

6. <u>Issues for charities that have been involved in tax shelter donation programmes</u>

Where a charity has been involved in a tax shelter donation scheme prior to the announcement of proposed changes to the Act provisions on December 5, 2003, the following are some of the issues that the charity will need to be considered:

- A tax shelter registration does not in itself give the donation program any protection;
- There may be difficulties in establishing the fair market value of the goods being donated,[12]
- The onus is on the charity to arrange a qualified appraisal of the donation, not on the promoter or the donor;
- There may be an issue of establishing donative intent by the donor;
- It is important to determine whether the donations are gifts of capital or inventory, determined preferably by means of an independent tax opinion;
- Possible third party penalties may be levied against a charity's for improper valuation of the fair market value of items donated;
- Potential assessment challenges of donors by CRA with possible claims against the charity;
- Potential problems in complying with a charity's disbursement quota;
- Due diligence requirements on the part of the charity in receiving, monitoring and disbursing products that are donated;
- Did the charity obtain independent legal advice;
- Where a legal defence fund has been promised, questions of sufficiency need to be considered and whether it is available for the benefit of the charity as opposed to donors;
- Possible loss of charitable status by the charity; and
- Possible exposure of directors for personal liability to donors who are reassessed.

Given the numerous warnings by CRA leading up to the announcement of proposed legislation by the Department of Finance on December 5, 2003, charities that did become involved in tax shelter donation schemes may have cause for concern if CRA decides to initiate an assessment of a charity that was involved in one of these schemes. In the future, charities and their boards of directors will want to be extremely cautious before becoming involved in any donation program that promises results to the donor or the charity that seem too good to be true, because they probably are.

C. LEGISLATIVE PROPOSALS FROM THE FEBRUARY 2004 AMENDMENTS

In addition to consolidating and amending the anti-tax shelter provisions introduced in the December 2003 Amendments, the February 2004 Amendments constitute a consolidation of, and further amendment to, previously proposed technical amendments introduced by the Department of Finance in the December 2002 Amendments,[13] and the December 2003 Amendments,[14] as well as

[12] *Klotz* v. *Canada*,[2004] T.C.J. No. 52 (T.C.C.).
[13]Details regarding the December 2002 Amendments have been summarized in *Charity Law Bulletin* No. 21 dated April 30, 2003, which is available at www.charitylawbulletin.ca/2003/chylb21.pdf.

introducing additional technical amendments to the Act. Although the December 2004 Amendments brought sweeping changes to the Act that affect charities, as described below, the changes embodied in the February 2004 Amendments were not impacted by the December 2004 Amendments.

1. <u>Consolidation of amendments</u>

a) Revised definition of gift for income tax purposes

At common law, property must be transferred voluntarily, without any contractual obligation and with no advantage of a material nature returned to the donor. Subsections 248(30) to (33) of the Act, introduced by the December 2002 Amendments, create a new concept of "gift" for tax purposes to provide a tax benefit to a donor even when the donor (or a person not dealing at arm's length with the donor) receives an advantage, provided that the value of the property exceeds the amount of advantage received. These subsections have been further amended by both the December 2003 and February 2004 Amendments. The Explanatory Notes to the February 2004 Amendments indicate that these subsections are added to "clarify the circumstances under which taxpayers and donees may be eligible for tax benefits available under the Act in respect of impoverishment of a taxpayer in favour of a donee."

The new subsection 248(30) of the Act introduced by the December 2002 Amendments defines the "eligible amount of a gift" to be the amount by which the fair market value of the property that is the subject of the gift exceeds the amount of any advantage received in respect of the gift. This subsection is amended slightly under the December 2003 Amendments to clarify that it is also applicable to monetary contributions made to registered parties and candidates. Subsection 248(30) is included in the February 2004 Amendments without further changes and applies to gifts made after December 20, 2002.

The definition of "advantage" is set out in subsection 248(31) that was introduced by the December 2002 Amendments. This subsection was substantially amended by both the December 2003 and February 2004 Amendments. It has now become paragraph

---

[14] Details regarding the December 2003 Amendments have been summarized in *Charity Law Bulletin* No. 38 dated February 19, 2004, which is available at www.charitylawbulletin.ca/2003/chylb38.pdf.

248(31)(a) of the Act, which provides that the amount of advantage in respect of a gift includes the value, at the time when the gift is made, of "any property, service, compensation or other benefit" that the donor, "a person or a person who does not deal at arm's length" with the donor, or "another person or partnership who does not deal at arm's length with and holds, directly or indirectly, an interest" in the donor, has "received, obtained or enjoyed, or is entitled, either immediately or in the future and either absolutely or contingently, to receive obtain or enjoy" that is (i) in consideration of, (ii) in gratitude of, or (iii) in "any other way related to the gift." (Changes to the original wording from the December 2003 Amendments have been underlined in the foregoing sentence.) Paragraph 248(31)(a) applies to gifts made after December 20, 2002, save and except that the provision concerning the phrase "in any other way related to the gift" in subparagraph 248(31)(a)(iii) applies to gifts made on or after 6 p.m. on December 5, 2003.

This expansion of the definition of "advantage" in subsection 248(31) of the Act to include an advantage that is "in any other way related to the gift" has broad implications. The advantage can be received prior to, at the same time as, or subsequent to the making of the gift by the donor. As well, it is not necessary for a causal relationship to exist between the making of the gift and the receiving of the advantage if they are "in any other way" related to each other. Furthermore, the definition of advantage is silent regarding from whom the advantage may be provided. Presumably, it could also include advantages provided by third parties, even unbeknownst to the charity issuing the charitable donation receipt.

Subsection 248(33) of the Act, introduced by the December 2002 Amendments, provides that the cost of property to the donor is the fair market value of the property at the time when the gift is made. Paragraph 248(32)(a) provides that if the amount of the advantage does not exceed 80% of the fair market value of the property, then the existence of an advantage to the donor will not necessarily disqualify the transfer from being a gift. Where the amount of an advantage exceeds 80% of the fair market value of the property, paragraph 248(32)(b) provides that it is up to the donor to establish to the satisfaction of the Minister of National Revenue (the "Minister") that the transfer was made with the intention to make a gift. Subsection 248(32), as it was introduced by the December 2002 Amendments, remains unchanged under the December 2003

Amendments, save and except the insertion of a clarification that the gifts in question are gifts made to “qualified donees”. Subsection 248(33), introduced by the December 2002 Amendments, also remains the same under the December 2003 Amendments, save and except the insertion of a clarification that this subsection also applies to monetary contributions made to registered parties and candidates. The wording of subsections 248(32) and (33) in the December 2003 Amendments is included in the February 2004 Amendments without further changes. These subsections apply to gifts made after December 20, 2002.

b) New definitions of charitable organizations and public foundations

Under the December 2002 Amendments, the definitions of charitable organizations and public foundations in subsection 149.1(1) were amended by replacing the previous “contribution” test with a new “control” test. The rationale for amending the definitions is to permit such charities to receive large gifts from donors without concern that they may be deemed to be private foundations. The changes to subsection 149.1(1) introduced by the December 2002 Amendments are consolidated in the February 2004 Amendments.

The original provisions of the Act require that not more than 50% of the capital contributed or otherwise paid to a charitable organization or public foundation be contributed by one person or members of a group of such persons who do not deal with each other at arm’s length. This is usually referred to as the “contribution” test. As a result of inquiries from the public, the Department of Finance proposed to amend the definition of both charitable organizations and public foundations in order to “ensure that in certain circumstances large donations are not prohibited” by permitting a person, or a group of persons not dealing with each other at arm’s length, to contribute more than 50% of the charity’s capital as long as such a person or group does not control the charity in any way or represent more than 50% of the directors, trustees, officers and similar officials of the charity. In general, this new definition is retroactively applicable to January 1, 2000. The changes introduced by the December 2002 Amendments are included in the February 2004 Amendments with the addition of minor wording in subparagraph (d)(ii) of both definitions to clarify the meaning of the new definition.

Registered charities that wish to apply under subsection 149.1(6.3) to change their designation as a result of the amendments described above will be required to apply within 90 days of when the February 2004 Amendments receive Royal Assent. These registered charities will then be deemed to be registered as charitable organizations, public foundations, or private foundations, as the case may be, in the taxation year that the Minister specifies.

As a result of the introduction of a "control" test, the convoluted rules under the Act in relation to "control" will become applicable, specifically due to the inclusion of the phrase "controlled directly or indirectly in any manner whatever" contained in the new definitions. However, the application of the rules concerning "control" in the charitable context is unclear, since these rules are premised upon application to commercial arrangements in a business context rather than for charitable corporations. As such, charity law practitioners will need to carefully review these rules when establishing charitable organizations and public foundations involving a major donor who contributed more than 50% of the capital for a charity, especially in the case of establishing a multiple corporate structure, in order to ensure that the charity in question will not inadvertently be caught by these rules that might otherwise lead to the unintended result of a charity being deemed a private foundation. As well, the current relationship of multiple corporate structures should also be reviewed in order to assess whether this new control test may have an undesirable effect.

c) Revocation of charitable registrations

Subsections 149.1(2), (3), and (4) of the Act provide for circumstances under which the charitable status of a charity may be revoked. Pursuant to the December 2002 Amendments, subsections 149.1(2), (3), and (4) will be amended to provide that gifts made by a charity to a non-qualified donee would become cause for revocation of the charitable status of the charity. These changes are included in the February 2004 Amendments without change and would apply to gifts made by charities after December 20, 2002. As a result of the possible loss of charitable status in making a disbursement to a non-qualified donee, charities will need to be more cautious than ever when making disbursements and ensure that all disbursements are either made in the course of carrying out their charitable activities or to qualified donees and that no disbursements are made to non-qualified donees unless there is an agency, joint venture or partnership agreement in place in accordance with the requirement of CRA.

2. <u>New amendments</u>

In addition to consolidating and amending legislative changes introduced by the December 2002 and December 2003 Amendments, the February 2004 Amendments also introduced two new changes to the Act.

a) Substantive gift

The February 2004 Amendments proposed the insertion of a new subsection 248(38) that applies to gifts of capital property and eligible capital property made on or after February 27, 2004, in order to prevent a donor from avoiding the application of the Deeming Provision set out in subsection 248(35) by disposing the property to a qualified donee and then donating the proceeds of disposition to either that qualified donee or to another qualified donee that does not deal at arm's length with the qualified donee that purchased the property from the donor, rather than donating the property directly to the qualified donee. The property disposed of by the donor is referred to as a "substantive gift" in this subsection. Under these situations, the Deeming Provision set out in subsection 248(35) would apply and the fair market value of the substantive gift and proceeds of sale would be "deemed" under subsection 248(38) to be the lesser of the fair market value of the substantive gift and the cost, or the adjusted cost base in the case of capital property, of the substantive gift to the taxpayer immediately before the disposition of the property to the qualified donee. This subsection does not apply to property exempted under subsection 248(36) referred to above.

b) New qualified donees

The February 2004 Amendments also propose to amend sections 110.1 and 118.1 of the Act by expanding the list of "qualified donees" as defined in subsection 149.1(1) to include municipal or public bodies performing a function of government in Canada. The Tax Court of Canada, in the case *Otineka Development Corporation Limited and 72902 Manitoba Limited* v. *The Queen*[15] held that an entity could be considered a municipality

[15] 94 D.T.C. 1234, [1994] 1 C.T.C. 2424.

for the purpose of paragraph 149(1)(d.5) on the basis of the functions it exercised. However, the Quebec Court of Appeal in *Tawich Development Corporation* v. *Deputy Minister of Revenue of Quebec*[16] held that an entity could not attain the status of a municipality by exercising municipal functions but only by statute, letters patent or order. In response to the Quebec Court of Appeal decision in *Tawich*, the February 2004 Amendments expand the definition of qualified donee in order to ensure that municipal or public bodies performing a function of the government in Canada are included.

D. DECEMBER 2004 AMENDMENTS IMPLEMENTING THE MARCH 2004 BUDGET

The March 2004 Budget represents a major initiative by the Federal Government in rewriting the tax rules concerning the taxation and administration of charities. The 2004 Budget reflects to a large extent the proposals of the Voluntary Sector Initiative's Joint Regulatory Table contained in its report of March 2003 "Strengthening Canada's Charitable Sector: Regulatory Reform", particularly as it relates to intermediate taxes and sanctions. The March 2004 Budget also rectifies a number of technical problems regarding disbursement quotas involving charities, most of which were identified in submissions by the Charities and Not-for-Profit Law Section of the Canadian Bar Association over the last three years.

The changes proposed in the March 2004 Budget were implemented by draft amendments to the Act in the September 2004 Amendments. The September 2004 Amendments were amended by a Notice of Ways and Means Motion tabled by the Minister of Finance in the House of Commons on December 6, 2004. Bill C-33, *A Second Act to Implement Certain Provisions of the Budget Tabled in Parliament on March 23, 200*4 was passed by Parliament on February 25, 2005, and received its first reading by the Senate on March 7, 2005.. The December 2004 Amendments implement the initiative of the Federal Government in rewriting the tax rules concerning the taxation and administration of charities as set out in the March 2004 Budget. In general, these initiatives include changes to the Act in the following areas:

- New intermediate sanctions and related matters, such as the transfer of assets upon revocation of charitable status and new rules regarding the annulment of registered charities;

[16] 2001 D.T.C. 5144.

- No trading in charitable donations;
- New appeal regime for registered charities, including a new internal reconsideration process and the appeal of taxes and penalties to the Tax Court of Canada;
- Transparency and accessibility of information concerning registered charities, including release of more information to the public concerning registered charities and organizations that are denied registration, inclusion of more information on official tax receipts, and increased information on the CRA website; and
- New disbursement quota rules.

These initiatives represent the most significant revision of the tax rules affecting charities under the Act in the last twenty years and will affect charities for many years to come. The following portion of this paper details the scope and timing of these changes and discusses the implications that the proposals contained in the December 2004 Amendments will have on existing as well as prospective charities. Where applicable, the paper will also point out the difference between the September 2004 Amendments and the December 2004 Amendments.

1. <u>Intermediate sanctions and related matters</u>

a) Intermediate taxes and penalties

The December 2004 Amendments introduced a new section 188.1 to put in place intermediate taxes and penalties to address the concern that the only recourse that CRA could impose on a registered charity[17] that did not comply with the requirements of the Act was to revoke its status as a registered charity. The Explanatory Notes to the December 2004 Amendments state that these penalties on registered charities are "more appropriate than revocation for unintended or incidental breaches of the Act," and that these penalties apply in respect of "activities that charities are not permitted to undertake." The Explanatory Notes also explain that "some penalties are progressive, increasing in severity for repeat infractions . . ."

In the March 2004 Budget, there was no mention of the length of the period that would be used in assessing penalties for repeat offences. In the September 2004 Amendments, a ten year period is introduced in this regard. However, the charitable sector was

[17] The *Income Tax Act* defines a registered charity in subsections 248(1) and 149.1(1).

concerned that using a ten year period seemed harsh, particularly where there could be a whole new regime running a charity with no knowledge of past transgressions. One can easily envision situations in which completely unrelated staff at different times, make similar mistakes in good faith. In response to this concern, the time period that will be used in assessing penalties for repeat infractions [set out in subsections 188.1(2), (3)(b), (4)(b), and (8)] was reduced from ten to five years in December 2004. However, the Explanatory Notes to the December 2004 Amendments have not been up-dated to reflect this change.

The Explanatory Notes also clarify that these sanctions apply "notwithstanding the discretion of the Minister to revoke the registration of a charity in respect of the same activities." These sanctions include taxation of gross revenue derived from business activities, suspension of tax-receipting privileges, monetary penalties, and taxation of gifts and transfers to other registered charities. These changes are introduced concurrently with amendments to section 189 of the Act, which introduces a process for assessment and dispute resolution. These measures will apply in respect of taxation years that begin after March 22, 2004. The proposed amendments to the Act in this regard can be summarized as follows:

i) Carrying on business

Subsection 188.1(1) imposes a penalty equal to 5% of the gross income earned from any business in a taxation year if (a) the business is carried on by a private foundation, or (b) the business is "not a related business in relation to" a charitable organization or a public foundation in question. Upon a repeat infraction within five years of a previous infraction under either subsection 188.1(1) or 188.1(2), the penalty is increased to 100% of the gross revenue earned from the applicable businesses in a taxation year. In other words, all repeat infractions within five years are subject to 100% penalties. In addition, upon repeat infractions, subsection 188.2(1) provides that the registered charity's tax-receipting privileges shall be suspended.[18]

[18] See details in section D.1.b) below regarding the procedures required in order to suspend this privilege.

ii) Control of corporation by a charitable foundation

Pursuant to paragraph 188.1(3)(a), if a "charitable foundation" (i.e. either a public foundation or a private foundation) acquires control over a corporation "within the meaning of subsection 149.1(12)" of the Act, then the foundation would be subject to a penalty that is equal to 5% of the dividend received by the foundation in a taxation year during the period when the corporation is so controlled by the charity. The Explanatory Notes explain that if the foundation either "continues to control the corporation or has again acquired control of a corporation" within five years of a previous infraction under either paragraph 188.1(3)(a) or paragraph 188.1(3)(b), then the penalty will be equal to 100% of the dividend received pursuant to paragraph 188.1(3)(b).

iii) Conferment of undue benefits

Paragraph 188.1(4)(a) imposes a penalty equal to 105% of any "undue benefit" conferred by a registered charity on any person. Pursuant to paragraph 188.1(4)(b), the penalty is increased to 110% of the amount of undue benefit conferred upon repeat infractions within five years. In addition, upon repeat infractions, subsection 188.2(1) also provides that the registered charity's tax-receipting privileges shall be suspended.[19]

"Undue benefit" is a new term under the Act and is broadly defined under subsection 188.1(5). Pursuant to subsection 188.1(5), "undue benefit" includes the following:

(a) a disbursement by way of a gift,[20] and
(b) the amount of any part of "income, rights, property or resources" of the charity that is "paid, payable, assigned or otherwise made available for the personal benefit of any person":
    (i) who is a "proprietor, member, shareholder, trustee or settlor" of the charity; or

[19] See details in section D.1.b) below regarding the procedures required in order to suspend this privilege.
[20] But see explanation below regarding exception in paragraph 188.1(5)(c) exempting a gift to a qualified donee.

(ii) who has “contributed or otherwise paid into the charity more than 50% of the capital of the charity”, or

(iii) who “deals not at arm’s length with a person” mentioned in (i) or (ii) above, or with the charity.

The benefit may be conferred by the charity. The benefit may also be conferred by “another person, at the direction or with the consent of the charity,” that the charity would otherwise have a right to that benefit.

However, an undue benefit does not include a disbursement or benefit that is:

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

(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.

Paragraph 188.1(5)(c) provides that an undue benefit includes a disbursement by way of a gift but does not include a gift to a qualified donee. In other words, a gift to a non-qualified donee would be within the meaning of undue benefit. The March 2004 Budget indicates that a gift that is restricted under subsections 149.1(2), (3) or (4) of the Act would be subject to a 105% tax on the amount of undue benefit, and 110% tax on the amount of undue benefit and suspension of tax-receipting privileges. Although no specific reference in this regard is made in the December 2004 Amendments, it would appear that the proposal in the March 2004 Budget is implemented through paragraph 188.1(5)(c).

This definition of “undue benefit” is so broad that it would include a benefit conferred by the charity or by a third party and may lead to unintended results. For example, the broad wording of paragraph 188.1(5)(b) would seem to create an undue benefit in a situation where a donor to a religious charity, such as church, who is also a member, has a daughter who is to be married in the church but whose eligibility to be married in the church is conditional upon the daughter becoming a member in that church.

iv) Failure to file information

Pursuant to subsection 188.1(6), a penalty of $500 will be imposed on a charity that fails to file or is late in filing the annual information return required under subsection 149.1(14) of the Act for a taxation year. The penalty is the same for repeat infractions.

v) Incorrect information on official donation receipts

Subsection 188.1(7) imposes a penalty equal to 5% of the amount reported on an official donation receipt as representing the amount in respect of which a taxpayer may claim a deduction under subsection 110.1(1) or a credit under subsection 118.1(3), if the information shown on the receipt is not in accordance with the Act or the *Income Tax Act Regulations.* Pursuant to subsection 188.1(8), the penalty upon repeat infractions within five years is increased to 10% of the amount shown on the receipt. In this regard, concurrent with the introduction of subsections 188.1(6) and (7), it is proposed that sections 3501 and 3502 of the *Income Tax Act Regulations* be amended to require that official donation receipts issued after 2004 include the current internet address of CRA. In a publication by CRA entitled "New requirement for official donation receipts - Questions and Answers" published on January 18, 2005, CRA indicated that although donation receipts issued as of January 1, 2005 are expected to comply with this requirement, donation receipts not in compliance with this requirement will be accepted by CRA in 2005 and that charities would not be penalized for not including the new information in 2005. It also indicates that if the current stock of receipts does not contain this information, it will be acceptable to include the information by other means, such as sticker, stamp, handwritten, etc.

vi) False information on official donation receipts

Subsection 188.1(9) of the Act imposes a penalty equal to 125% of the amount shown on a receipt "issued by, on behalf of or in the name of another person," on a person who "makes or furnishes, participates in the making of or causes another person to make or furnish a statement" on the said receipt that the person "knows, or would reasonably be expected to know but for circumstances amounting to culpable conduct (within the meaning assigned by subsection 163.2(1)), is a false statement (within the meaning assigned by subsection 163.2(1))."[21] If the person is "an officer, employee, official or agent" of a registered charity, then the penalty may be imposed on the registered charity. Subsection 188.1(10) provides that if a person is liable for penalties under both section 163.2 and subsection 188.l(9) in respect of the same statement, then the penalty is limited to the greater of those two penalties. In addition, if the total penalty for a taxation year exceeds $25,000 under subsection 188.1(9), then subsection 188.2(1) provides that the registered charity's tax-receipting privileges shall also be suspended.[22] In other words, if the receipted amount is over $20,000 and if a penalty is assessed under subsection 188.1(9), then subsection 188.2(1) would apply and the charity's tax-receipting privileges shall also be suspended.

vii) Delay of expenditure

Subsection 188.1(11) imposes a penalty equal to 110% of the fair market value of property transferred from one registered charity to another registered charity by way of a gift where it "may reasonably be considered that one of the main purposes for the making of the gift was to unduly delay the expenditure of amounts on charitable activities." In such a situation, each of the two charities are "jointly and severally, or solidarily" liable for the penalty.

[21] Section 163 of the Act imposes civil penalties on third parties. Subsection 163.2(1) provides that "culpable conduct" means "conduct, whether an act or a failure to act" that is (a) "tantamount to intentional conduct", (b) "shows an indifference as to whether this Act is complied with" or (c) "shows a willful, reckless or wanton disregard of the law."

[22] See details in section D.1.b) below regarding the procedures required in order to suspend this privilege.

b) Procedures to suspend tax-receipting privileges

Section 188.2 of the Act introduced by the December 2004 Amendments confers the power on the Minister to suspend tax-receipting privileges under certain circumstances.

Subsection 188.2(1) provides that once the Minister issues an assessment giving notice by registered mail of a penalty under any of the following three situations, then the registered charity would be suspended from issuing official donation receipts for a period of one year, seven days after the mailing of the said assessment:

(a) subsection 188.1(2);
(b) paragraph 188.1(4)(b); or
(c) subsection 188.1(9) if the total penalties for a taxation year exceeds $25,000 as explained above.

Subsection 188.2(2) goes on to provide that the Minister may also suspend a registered charity's tax-receipting privilege under two additional situations:

(a) if the charity contravenes any of sections 230 to 231.5 of the Act, i.e. sections of the Act relating to administration and enforcement, such as the requirement to keep proper books and records; or
(b) if it may "reasonably be considered" that the registered charity has "acted in concert" with another charity in avoiding the effect of a suspension by accepting a gift or transfer of property on behalf of the suspended charity.

Paragraph 188.2(3)(a) provides that the issuance of the assessment notice by the Minister under subsection 188.2(1) or (2) would have the effect of deeming the registered charity in question not to be a qualified donee for purposes of the Act during the one year period commencing seven days after the mailing of the assessment by the Minister. In addition, paragraph 188.2(3)(b) provides that if the registered charity is offered a gift during the said one-year period, then the charity must inform the donor of the following before accepting the gift:

(i) the charity has received the said assessment notice from the Minister;
(ii) no charitable deduction or credit may be claimed by the donor; and
(iii) the gift made would not be a gift made to a qualified donee.

Subsection 188.2(4) provides that the registered charity in question may, after having filed a notice of objection to a suspension, file an application with the Tax Court of Canada for a postponement of that portion of the period of suspension that has not elapsed until the time determined by the Court. Subsection 188.2(5) provides that the Court may grant such an application only if it would be "just and equitable" to do so.

From a practical standpoint for donors, although registered charities whose tax-receipting privilege have been suspended have to advise donors of the same under paragraph 188.2(3)(b), it would be helpful to charities for CRA to publish on its website a list of all registered charities whose tax-receipting privilege has been suspended in order to avoid donors making donations to these entities.

c) Summary of intermediate taxes and penalties

The following chart was included in the March 2004 Budget to provide specifics of the infraction in question, together with taxes and penalties that apply for both first infractions and repeat infractions. We have expanded the chart by including the relevant sections of the Act set out in the December 2004 Amendments.

Infraction	**Tax or Penalty (Unless registration of the charity is revoked)**			
	First infraction		**Repeat infraction** (Repeated acts or omissions will increase the probability of revocation)	
	Penalty	Proposed sections of the Act	Penalty	Proposed sections of the Act
Late filing of annual information return	$500 penalty	188.1(6)	$500 penalty	188.1(6)
Issuing of receipts with incomplete information	5% penalty on the eligible amount stated on the receipt	188.1(7) [also see amendments to sections 3501 and 3502 of the *Income Tax Act Regulations]*	10% penalty on the eligible amount stated on the receipt	188.1(8) [also see amendments to sections 3501 and 3502 of the *Income Tax Act Regulations]*
Failure to comply with certain verification and enforcement sections of the Income. Tax Act (230 to 2315), e.g. keeping proper books and records	Suspension of tax-receipting privileges	188.2(2)	Suspension of tax-receipting privileges	188.2(2)

Infraction	Tax or Penalty (Unless registration of the charity is revoked)			
	First infraction		Repeat infraction (Repeated acts or omissions will increase the probability of revocation)	
	Penalty	Proposed sections of the Act	Penalty	Proposed sections of the Act
Charitable organization or public foundation carrying on an unrelated business	5% tax on gross unrelated business revenue earned in a taxation year	188.1(1)	100% tax on gross unrelated business revenue earned in a taxation year and suspension of tax-receipting privileges	188.1(2) and 118.2(1)
Private foundation carrying on any business	5% tax on gross business revenue earned in a taxation year	188.1(1)	100% tax on gross business revenue earned in a taxation year, and suspension of tax-receipting privileges	188.1(2) and 118.2(1)
Foundation acquires control of a corporation	5% tax on dividends paid to the charity by the corporation	188.1(2)(a)	100% tax on dividends paid to the charity by the corporation	188.1(3)(b)
Undue personal benefit provided by a charity to any person.	105% tax on the amount of undue benefit	188.1(4)(a) [“undue benefit is defined in 188.1(5)]	110% tax on the amount of undue benefit and suspension of tax-receipting privileges	188.1(4)(b) and 188.2(1) [“undue benefit is defined in 188.1(5)]
A gift that is restricted under subsections 149.1(2), (3) or (4) of the Act	105% tax on the amount of the gift	188.1(4)(a) [“undue benefit is defined in 188.1(5)]	110% tax on the amount of the gift	188.1(4)(b) and 188.2(1) [“undue benefit is defined in 188.1(5)]
Issuing receipts in a taxation year for eligible amounts that in total do not exceed $20,000 if there is no gift or if the receipt contains false information	125% tax on the eligible amount stated on the receipt	188.1(9) and (10)	125% tax on the eligible amount stated on the receipt	188.1(9) and (10)
Issuing receipts in a taxation year for eligible amounts that in total exceed $20,000, if there is no gift or if the receipt contains false information	Suspension of tax-receipting privileges and 125% tax on the eligible amount stated on the receipt	188.2(1) and 188.1(9) and (10)	Suspension of tax-receipting privileges and 125% tax on the eligible amount stated on the receipt	188.2(1) and 188.1(9) and (10)
Delaying expenditure of amounts on charitable activities through the transfer of funds to another registered charity	The charities involved are jointly and severally, or solidarily, liable for 110% of the amounts so transferred	118.1(11)	The charities involved are jointly and severally, or solidarily, liable for 100% of the amounts so transferred	118.1(11)
Assisting another registered charity in avoiding the effect of a suspension of tax-receipting privileges by accepting gifts or transfer of property on behalf of the suspended charity	Suspension of tax-receipting privileges	188.2(2)	Suspension of tax-receipting privileges	188.2(2)

2. Other matters relating to penalties

a) Reduction of penalties

The December 2004 Amendments provide that where a charity is required to pay taxes or penalties which total more than $1,000 in a particular taxation year, the charity will be permitted to reduce the tax or penalty liability by certain amounts. Specifically, new subsection 189(6.3) applies to registered charities that the Minister assesses for penalties under section 188.1 for a taxation year in excess of $1,000. The charity may reduce the liability by the value of property transferred to an eligible donee in the one-year period following the assessment date, exceeds the consideration given to the charity. New subsection 189(6.3) applies to notices issued by the Minister after the day that is 30 days after Royal Assent.

b) Interest on penalties

Subsection 189(7) of the Act currently applies in respect of interest applicable to liabilities under Part V of the Act. This subsection is replaced with subsection 189(9) of the Act. New amended subsection 189(9) modifies subsection 161(11) for the purposes of liabilities under Part V. In this regard, interest on penalties under section 188.1 of the Act accrues only on the balance remaining one year after the liability was first assessed. Subsection 189(9) applies in respect of notices issued by the Minister after the day that is 30 days after Royal Assent.

c) Appeals

Appeals from decisions concerning refusal to grant registered charitable status or revocation of registered charitable status will continue to be made to the Federal Court of Appeal. However, appeals of taxes and penalties will be directed to the Tax Court of Canada. Specifically, subsection 189(8.1) clarifies that a taxpayer may not appeal to the Tax Court of Canada in respect of an issue that could be the subject of a notice of objection filed under new subsection 168(4) of the Act. This amendment applies in respect of notices issued by the Minister after the day that is 30 days after Royal Assent. This is discussed in greater detail later in this paper.

3. Refusal to register

New subsection 149.1(22) will be included in the Act to require the Minister to provide notice by registered mail to a person where the application for registration as a charity by the person is denied. The introduction of subsection 149.1(22) is concurrent with the introduction of new subsection 168(4) of the Act, which provides a person a right to file a notice of objection in respect of a decision of the Minister. Subsection 149.1(22) applies in respect of notices issued by the Minister after the day that is 30 days after Royal Assent.

4. Annulment

The December 2004 Amendments provide explicit authority for the Minister to annul an organization's registration under certain circumstances. In this regard, similar to new subsection 149.1(22), new subsection 149.1(23) requires the Minister to provide a notice by registered mail to a person where the registration of the person as a registered charity is annulled, if the person was registered in error or if the person has ceased to be a charity "solely as a result of a change in law." Once annulled, the organization is deemed not to have been registered at all, and, as such, the annulment would not invoke any revocation tax. New subsection 149.1(24) provides that official receipts issued by a registered charity prior to the annulment will be accepted as valid notwithstanding the annulment, as long as the receipts would have been valid were the registration had not been annulled.

Subsections 149.1(23) and (24) apply in respect of notices issued by the Minister after the day that is 30 days after Royal Assent. Similar to the reason for the introduction of new subsection 149.1(22), these two subsections are introduced concurrent with the introduction of new subsection 168(4) of the Act, which provides a person a right to file a notice of objection in respect of a decision of the Minister.

5. Revocation

a) Revocation of charitable status that was obtained based on false information

The March 2004 Budget indicated that the Minister would retain the right to revoke the registered status of a charity in the event of severe breaches of the Act, including where the organization obtained its registration status on the basis of false or deliberately misleading information. However, the September 2004 Amendments did not bring proposed provisions to permit the revocation of charitable status of charities in this regard.

As a result of the omission in the September 2004 Amendments, in December 2004, it was proposed to change subsection 149.1(4.1) of the Act to provide that "if a false statement, within the meaning assigned by subsection 163.2(1), was made in circumstances amounting to culpable conduct . . . in the furnishing of information for the purpose of obtaining registration of the charity," then the Ministry may revoke the charitable registration of that charity. Subsection 163.2(1) defines a "false statement" to include a statement that is "misleading because of an omission from the statement." This amendment applies in respect of notices of intention to revoke the registration of a charity issued by the Minister after the day that is 30 days after Royal Assent.

b) Revocation tax

The Minister retains the right to revoke the registration of a charity in the event of severe breaches of the Act, including where the organization is being operated for purposes that are not charitable or where an organization obtained its registration status on the basis of false or deliberately misleading information. The December 2004 Amendments provide for a modified regime of the imposition of revocation tax under Part V of the Act. These new measures, save and except subsection 188(3.1), will apply to notices and certificates issued by the Minister after the day that is 30 days after Royal Assent. Subsection 188(3.1) applies to taxation years that begin after March 22, 2004. In short under this modified regime, revocation tax has been tightened as evidenced in the sections discussed below:

i) Deemed year-end on notice of revocation

Subsection 188(1) of the Act currently imposes a revocation tax on charities in respect of which the Minister has revoked a registration. A revoked charity has one year from the date of revocation to file a return that discloses the extent to which the charity has divested itself of its assets to other registered charities or qualified donees. The balance of the net assets of a revoked charity, after the divestiture, must be paid to the Crown as a revocation tax.

Subsection 188(1) is amended to provide a one-year "winding-up period" to begin on the date the Minister issues a notice of intention to revoke the registration of a charity (under any of subsection 149.1(2), (3), (4), (4.1) and 168(1)) or if it is determined, under subsection 7(1) of the *Charities Registration (Security Information) Act*, that a certificate issued in respect of the charity under subsection 5(1) of the Act is reasonable. Specifically, the taxation year of the revoked charity is deemed to have ended on the date of the notice, a new taxation year of the revoked charity is deemed to begin immediately after that date, and the revoked charity is deemed not to have established a fiscal period before that day. The one-year winding-up period may be extended pursuant to subsection 188(1.2).[23] Amended subsection 189(8)[24] of the Act continues to provide for assessment by the Minister of the tax in a manner similar to that for taxpayers liable under Part I of the Act.

ii) Calculation of revocation tax

A new subsection 188(1.1) is added to establish how the revocation tax is to be calculated. This formula for calculation is different from the formula under the current paragraph 188(1)(a). Pursuant to the new subsection 188(1.1), the revocation tax is equal to the difference between amount "A" and amount "B". Amount "A" is defined in subsection 188(1.1) to include the following three amounts:

a) the fair market value of the property of the revoked charity at the end of that taxation year that is deemed to have ended under subsection 188(1);
b) the amount of an "appropriation" (under subsection 188(2))[25] in respect of property transferred to another person in the 120-day period that ended at the end of that taxation year; and
c) income earned by the revoked charity, including all gifts and other income that would otherwise be subject to tax under section 3 of the Act if the charity were taxable.

---

[23] See explanation in relation to new subsection 188(1.2) in Section 5b)iii) below.
[24] See explanation in relation to new subsection 189(8) in Section 5f) below.
[25] See explanation in relation to new subsection 188(2) in Section 5b)v) below.

Amount "B" is defined in subsection 188(1.1) to include the following three amounts:

a) A debt of the charity that is outstanding at the end of that taxation year;

b) An expenditure made by the charity during the winding-up period on charitable activities carried on by it; and

c) An amount equal to property transferred to "eligible donees"[26] exceeds the consideration given by the "eligible donees" for the charity, if such a transfer is made within the winding-up period but before the latter of the end of the winding-up period and the day referred to paragraph 188(1.2)(c).[27] The Explanatory Note explain that if the charity does not file a notice of objection in respect of an assessment of the revocation tax, the time for making such a gift to an eligible donee is limited to one year from the date on which the taxation year is deemed to end.

iii) Winding-up period

As indicated above, the December 2004 Amendments introduces a "winding-up period", which, pursuant to new subsection 188(1.2), begins immediately after the date the Minister issues a notice of intention to revoke the registration of a charity (under any of subsections 149.1(2), (3), (4), (4.1) and 168(1)) or if it is determined, under subsection 7(1) of the *Charities Registration (Security Information) Act*, that a certificate issued in respect of the charity under subsection 5(1) of the Act is reasonable. The winding-up period ends at the latest of three dates:

a) the day on which the charity files a return under subsection 189(6.1) in respect of the revocation tax, but not later than one year after the notice or certificate was issued;

b) the day of the last assessment of revocation issued by the Minister; and

c) if the charity has filed a notice of objection or has appealed in respect of the assessment, the day on which the Minister may decide to take a

---

[26] See explanation in relation to eligible donees in new subsection 188(1.3) in Section 5b)iv) below.

[27] See explanation in relation to the winding-up period in new subsection 188(1.2) in Section 5b)iii) below.

collection action under section 225.1 of the Act in respect of the tax payable.

In this regard, the Explanatory Notes, provides an explanation of the application and interplay of sections 188 and subsections 189(6.1), 189(6.2).

iv) Eligible donee

The December 2004 Amendments require that the assets of a registered charity whose charitable status has been revoked can only be transferred to "eligible donees", rather than to qualified donees defined under the Act. In this regard, when calculating the amount "B" in paragraph 188(1.1)B(c), new subsection 188(1.3) provides that an "eligible donee" must be a registered charity that satisfies all of the following requirements:

a) more than 50% of the members of its board of directors or trustees deal at arm's length with each member of the board of directors or trustees of the charity whose charitable status is being revoked;
b) it is not the subject of a suspension of the ability to issue official donation receipts under subsection 188.2(1);
c) it does not have unpaid liabilities under the Act or under the *Excise Tax Act*;
d) it has filed all information returns required by subsection 149.1(14) (i.e. Annual T3010 Information Returns); and
e) it is not subject to a certificate under the *Charities Registration (Security Information) Act*.

From a practical standpoint, since CRA does not provide a list of registered charities that qualify as eligible donees, it would be difficult for the revoked charity to determine if the transferee is an eligible donee. As such, unless information is published by CRA in this regard, the revoked charity would need to exercise diligence to determine this information either by obtaining confirmation from CRA or by obtaining assurance from the transferee registered charity.

v) Shared liability or revocation tax

Subsection 188(2) is amended to impose a liability for the revocation tax payable by a revoked charity under subsection 188(1) jointly and severally, or solidarily, with persons who receives property from the revoked charity 120 days before the end of the taxation of the year that is deemed to have ended under subsection 188(1). The shared liability is not to exceed the total of all appropriations, each of which is the amount by which the fair market value of such a property so received by the person exceeds the consideration given by the person in respect of the property.

vi) Non-application of revocation tax

New subsection 188(2.1) provides that the Part V revocation tax does not apply in two situations:

a) where the Minister notifies the charity that the intention to revoke has been abandoned; or
b) where the Minister has re-registered the charity within the one-year winding-up period and that the charity has paid all other amounts owing under the Act or the *Excise Tax Act* and has filed all information returns required to be filed under the Act on or before that time.

New subsection 188(3.1) also provides that the Part V revocation tax does not apply to a transfer that is a gift to which the new subsection 188.1(11) applies. As explained above, new subsection 188.1(11) introduced by the December 2004 Amendments impose a penalty equal to 110% of the fair market value of property transferred from one registered charity to another registered charity by way of a gift where it "may reasonably be considered that one of the main purposes for the making of the gift was to unduly delay the expenditure of amounts on charitable activities." In such a situation, each of the two charities are "jointly and severally, or solidarily" liable for the penalty. This amendment applies for taxation years that begin after March 22, 2004.

c) Revoked charity to file returns

New subsection 189(6.1) requires a taxpayer that is liable for a revocation tax under new subsection 188(1.1) to file a return, within one year from the date of the certificate or notice, without notice or demand, and to estimate and pay tax payable. The person must also file any information returns required to be filed under subsection 149.1(14) of the Act. This new subsection will apply to notices and certificates issued by the Minister after the day that is 30 days after Royal Assent.

d) Reduction of revocation tax and penalties

As explained earlier, the December 2004 Amendments provide that where a charity is required to pay taxes or penalties which total more than $1,000 in a particular taxation year, the charity will be permitted to reduce the tax or penalty liability by certain amounts.

Specifically, subsection 189(6.2) applies if the Minister assesses revocation tax under subsection 188(1.1) in excess of $1,000 at a time that is less than one year after the day of the notice or certificate is issued. When this subsection applies, the amount of revocation tax during the balance of the one-year period (also known as "post-assessment period") is reduced by (1) the amount of expenditure by the charity in the post-assessment period in respect of charitable activities that exceed its net income in that period, and (2) the amount of property transferred by the charity to eligible donees in that period exceeds the consideration given to the charity. However, subsection 189(6.2) is nullified if, after the one-year period, the Minister issues an assessment of the revocation tax under new subsection 188(1.1), and any reduction in tax liability by such transfer and expenditures is incorporated into that assessment.

Similarly, new subsection 189(6.3) applies to registered charities that the Minister assesses for penalties under section 188.1 for a taxation year in excess of $1,000. The charity may reduce the liability by the value of property transferred to an eligible donee in the one-year period following the assessment date, exceeds the consideration given to the charity. New subsections 189(6.2) and (6.3) apply to notices issued by the Minister after the day that is 30 days after Royal Assent.

e) Minister may assess at any time

Subsection 189(7) of the Act currently applies in respect of interest applicable to liabilities under Part V of the Act. This subsection is replaced with subsection 189(9) of the Act. New subsection 189(7) now clarifies that the Minister may at any time assess a taxpayer under Part V, notwithstanding the authority of the Minister to revoke the registration of a registered charity. This subsection applies to notices issued by the Minister after the day that is 30 days after Royal Assent.

f) Provisions applicable to Part V

Subsection 189(8) provides that certain provisions of Part I of the Act relating to returns, assessments, payments and appeals are applicable to the taxes payable under Part V in respect of registered charities. This subsection is amended consequential to amendments to revocation tax under section 188 and the introduction of penalties and suspension of tax-receipting privileges under new sections 188.1 and 188.2. This amendment applies in respect of notices issued by the Minister after the day that is 30 days after Royal Assent. Furthermore, subsection 189(8.1) clarifies that a taxpayer may not appeal to the Tax Court of Canada in respect of an issue that could be the subject of a notice of objection filed under new subsection 168(4) of the Act.

g) Interest

As explained above, subsection 189(7) of the Act currently applies in respect of interest applicable to liabilities under Part V of the Act. This subsection is replaced with subsection 189(9) of the Act. New amended subsection 189(9) modifies subsection 161(11) for the purposes of liabilities under Part V. In this regard, interest on revocation tax under subsection 188(1.1) accrues only on the balance remaining at the time that is one year after the day on which the person was issued a certificate under the *Charities Registration (Security Information) Act* or a notice by the Minister of an intention to revoke the registration of a charity. In addition, interest on penalties under section 188.1 of the Act accrues only on the balance remaining one year after the liability was first assessed. Subsection 189(9) applies in respect of notices issued by the Minister after the day that is 30 days after Royal Assent.

6. Restrictions on trading charitable donations

Individuals who make charitable donations may carry forward their unused credit balances for up to five years. Similarly, corporations may also carry forward unused charitable donation deductions for up to five years. However, the Act does not permit individuals or corporations to sell or transfer these unused claims to other taxpayers.

In order to ensure that an individual who could not otherwise use surplus charitable donation tax credits also cannot do so indirectly by means of a transfer of property to a corporation, a new subsection 110.1(1.2) is proposed to be inserted into the Act. Paragraph 110.1(1.2)(a) provides that unused charitable donation deductions of a corporation are deductible only for taxation years that end before the time that control of the corporation is acquired by a person or a group of persons. This will ensure that unused charitable donation deductions cannot be traded by having unused charitable donation deductions of a corporation treated in a manner that is similar to the treatment accorded to capital losses. Paragraph 110.1(1.2)(b) goes on to deny an unused charitable donation deduction in respect of a gift made by any corporation before the control of the corporation is acquired by a person or a group of persons, if the property that is the subject of the gift was acquired by the corporation (before the making of the gift) under an arrangement under which it was expected that control of the corporation would be so acquired and a gift would be so made. This new rule does not apply where the person or group of person who acquires control of the corporation is a qualified donee that received the gift in question. These amendments will apply in respect of gifts made after March 22, 2004.

7. Appeals regime

The March 2004 Budget attempts to make the appeal process more accessible and affordable for registered charities and unsuccessful applicants for charitable status than has been the case in the past. As a result of this initiative, the following amendments to the Act are introduced in the December 2004 Amendments. However, the new objection and appeal process will not apply to an applicant or a registered charity that is subject to a certificate under the *Charities Registration (Security Information) Act.*

a) Internal reconsideration process

The December 2004 Amendment propose to extend the application of CRA's existing internal objection review process to notices of a decision by the Minister. In this regard, section 168 of the Act deals with circumstances in which the Minister may revoke the registration of a charity or a registered Canadian amateur athletic association.

New subsection 168(4) of the Act is proposed to be inserted into the Act to permit an organization that wishes to avail itself of a new internal reconsideration process by filing a notice of objection within 90 days from the issuance by CRA of the notice being objected to. The results of the review will be communicated in writing and no appeal can be made to a court unless the objection process has been exhausted. In particular, subsection 168(4) provides that a person may file a notice of objection if the person objects to a notice of intention to revoke the registration of a charity (subsection 168(1)), revocation of a charity's registration (subsections 149.1(2), (3), (4), or (4.1)), designation of a charity as a private or public foundation or charitable organization (subsection 149.1(6.3)), denial of applications for charitable status (new subsection 149.1(22)), or annulment of a charity's registration (new subsection 149.1(23)). The filing of a notice of objection is a required step before the person may appeal to the Federal Court of Appeal under subsection 172(3). New subsection 168(4) applies in respect of notices issued by the Minister after the day that is 30 days after Royal Assent.

Subsection 168(4) in the September 2004 Amendments indicates that upon the filing of a notice of objection, the provisions of subsections 165(1) to (1.2), and (2.1) to (6), and sections 166, 166.1 and 166.2 apply, "with any modifications that the circumstances require, as if the notice were a notice of assessment made under section 152. With respect to section 165, this means that subsections 165(1), (1.1), (1.11), (1.12), (1.13), (1.14), (1.15), (1.2), (2.1), (3), (5), and (6) would apply. However, subsection 168(4) has been revised in December 2004 to provide that subsections 165(1), (1.1) and (3) to (7) and sections 166, 166.1 and 166.2 apply. This means that subsections (1.11), (1.12), (1.13), (1.14), (1.15), (1.2), and (2.1), would not apply, and subsection (7) would apply instead.

Subsection 168(3) of the Act currently provides that, notwithstanding (a) the issuance of a notice of intention from the Minister to revoke the registration of a charity pursuant to subsection 168(1) of the Act or (b) an application from a person to the Federal Court of Appeal for a stay of publication of such a notice under subsection 168(2) of the Act, the registration of the charity is revoked as of the time that a certificate issued under the *Charities Registration (Security Information) Act* is determined to be reasonable. As a result of the introduction of new subsection 168(4), subsection 168(3) is expanded to include a third scenario (in addition to scenarios (a) and (b) above) in respect of notices of objection filed under 168(4). This means that the registration is also revoked as of the time that a certificate issued under the *Charities Registration (Security Information) Act* is determined to be reasonable notwithstanding that the person may have filed a notice of objection under subsection 168(4). The amendment to subsection 168(3) applies in respect of notices issued by the Minister after the day that is 30 days after Royal Assent.

It is also important to note that subsection 168(2) remains unchanged. This means that the Minister retains the option to publish in the Canada Gazette a copy of a notice of intention to revoke the registration of a charity, if at least 30 days have elapsed since the notice was issued. The Explanatory Notes to the December 2004 Amendments clarify that after the time of publication, the registration of a charity is revoked, notwithstanding that an objection may have been filed. The charity may apply to the Federal Court of Appeal for an extension of the 30-day period.

b) External appeals process

Appeals from decisions concerning refusal to grant registered charitable status or revocation of registered charitable status will need to continue to be made to the Federal Court of Appeal. This is unfortunate, as an appeal in this regard is a very costly process that few charities are in a financial position to pursue.

In this regard, subsection 172(3) of the Act currently provides a person with a right to appeal to the Federal Court of Appeal against a decision of the Minister to, *inter alia*, refuse the person's registration as a charity or a notice of intention by the Minister to revoke the registration of a charity or a refusal to designate a charity as a charitable organization, public foundation or private foundation, etc.

As a result of the introduction of the filing of notice of objection under new subsection 168(4), paragraphs 172(3)(a) and (a.1) are amended so that the right to appeal to the Federal Court of Appeal against a decision of the Minister in respect of a notice issued under any of subsections 149.1(2) to (4.1), (6.3), (22) or (23) or 168(1), will then apply in respect of the confirmation of the Minister of such a decision in response to a notice of objection filed under subsection 168(4). In addition, a person who has filed a notice of objection under subsection 168(4) will have the option to appeal the decision after 90 days have elapsed from the filing of the said notice of objection because, under that circumstance, the Minister would be deemed to have refused the objection.

As a result of the introduction of subsection 168(4) and the amendment of subsection 172(3), subsection 172(4) has to be amended to remove the right of registered charities to appeal to the Federal Court of Appeal within a 180-day appeal period because it is no longer applicable under the new appeal regime. Furthermore, the appeal period of 30 days set out in subsection 180(1) for the institution of an appeal to the Federal Court of Appeal is also amended to provide that for decisions of the Minister in respect of charities and applicants for status as a registered charity, this 30-day period begins from the day on which the Minister responds to a notice of objection filed under the new subsection 168(4).

However, appeals of taxes and penalties will be directed to the Tax Court of Canada. Specifically, subsection 189(8.1) clarifies that a taxpayer may not appeal to the Tax Court of Canada in respect of an issue that could be the subject of a notice of objection filed under new subsection 168(4) of the Act. The amended subsections 172(3)(a) and (a.1), 172(4) and 180(1) apply in respect of notices issued by the Minister after the day that is 30 days after Royal Assent.

8. <u>Transparency and accessibility of information</u>

a) Information pertaining to registered charities

Prior to the March 2004 Budget, the public could only obtain copies of annual information returns, governing documents with the names of directors, registration letters, and notices of revocation in relation to registered charities. The March 2004

Budget proposes to authorize the Minister to release to the public additional information where such information has been submitted to the Minister after 2004. The Explanatory Notes explain that the proposal is intended to "further enhance transparency and accessibility by making new information available on registered charities, the registration process, regulatory decisions, and compliance activities."

In this regard, subsection 241(3.2) currently permits a government official to release certain information relating to a registered charity, including the charity's governing documents, the application for charitable status, names of directors of the charity, notification of registration, and letter of revocation of registration. The December 2004 Amendments propose to amend subsection 241(3.2) by amending paragraph (e) and inserting new paragraphs (f) to (h) to allow for the disclosure of the following information to the public:

- Letters to a charity relating to grounds for revocation or annulment (paragraph 241(3.2)(e));
- Financial statements that are filed with the annual information return (paragraph 241(3.2)(f));
- The decision of CRA regarding a notice of objection filed by a registered charity (paragraph 241(3.2)(g));
- The identification of the registered charity which is subject to a sanction, the type of sanction imposed, as well as the letter sent to the registered charity relating to the grounds for the sanction (paragraph 241(3.2)(g)); and
- Information to support an application by a registered charity for special status or an exemption under the Act (e.g. request for permission to accumulate assets) (paragraph 241(3.2)(h)).

This amendment applies to documents sent by the Minister or that are filed or required to be filed with the Minister after the day that is 30 days after Royal Assent.

b) Information concerning organizations that are denied registration

Paragraph 241(4)(g) currently permits a government official to compile information in a form that does not directly or indirectly reveal the identity of the person to whom the information relates. The Explanatory Notes indicate that "in order to assist the charitable sector and the public in understanding how CRA determines whether an organization meets the criteria for registration as a registered charity," it "may make available its reasons for denying the registration of organizations, in such a manner as to withhold the identity of an applicant." Such information could include the governing documents of the applicant, information disclosed by the applicant in the course of making the application, a "copy of the notice of denial, and a copy of the decision, if any, of the Appeals Branch of CRA regarding a notice of objection, if any, filed by the organization." This initiative could result in an additional source of information for potential applicants who can use this to better gauge the nature of the criteria CRA will endorse in granting charitable status.

c) Additional information on official tax receipts

For official donation receipts issued after 2004, it is proposed that sections 3501 and 3502 of the *Income Tax Act Regulations* be amended to require that official donation receipts would need to include the current internet address of CRA.

9. Disbursement quota rules in December 2004 Amendments

a) Summary of disbursement quota rules prior to the proposed amendments

Before examining the new disbursement quota rules proposed in the December 2004 Amendments, it is first necessary to review the disbursement quota rules that are in place prior to the proposed amendments. The purpose of disbursement quota is "to ensure that most of a charity's funds are used to further its charitable purposes and activities; to discourage charities from accumulating excessive funds; and to keep other expenses at a reasonable level." [28] The disbursement quota for charitable organizations, public

[28] See Information Circular RC 4108, *Registered Charities and the Income Tax Act*, updated May 7, 2002, and available at http://www.cra-arc.gc.ca/E/pub/tg/rc4108/rc4108eq.html.

foundations and private foundations are different.[29] Disbursement quota is defined in paragraph 149.1(1) of the Act.[30]

i) Charitable organizations

Prior to the proposed amendments, the disbursement quota for a charitable organization is the total of two figures, i.e. variables "A" and "A.1", used in an algebraic formula contained in subsection 149.1(1) of the Act. Variable "A" is defined as 80% of the total of all amounts each of which the charity issued a donation receipt in its immediately preceding taxation year, other than the following:

(a) a gift of capital received by way of bequest or inheritance;
(b) a gift received subject to a trust or direction to the effect that the property given, or property substituted therefor, is to be held by the charity for a period of not less than 10 years (this is commonly known as "ten-year gifts"); and
(c) a gift received from another registered charity.

Variable "A.1" is defined to be 80% of the amounts that are (1) gifts of (i) capital received by way of bequests or inheritance for taxation years that begin after 1993 and (ii) ten-year gifts whenever they were received, (2) have previously been excluded from the charity's disbursement quota when calculating variable "A" above, and (3) are spent by the charity in the year.

ii) Public foundations

Prior to the proposed amendments, the disbursement quota for a public foundation is set out in the following formula:

$$A + A.1 + B + \{C \times 0.045\,[D - (E + F)]\} \div 365 + G$$

[29] For a discussion on the new definitions for charitable organizations, public foundations and private foundations proposed by draft amendments to the Act introduced on December 20, 2002 and consolidated in draft amendments to the Act introduced on February 27, 2004, please see *Charity Law Bulletin* No. 21 dated April 30, 2003 and *Charity Law Bulletin* No. 40 dated March 29, 2004.

[30] Although the definition for disbursement quota in paragraph 149.1(1) only makes reference to charitable foundations, this definition in effect also applies to charitable organizations – See paragraph 149.1(2)(b) and definition for "disbursement excess" in subsection 149.1(21) of the Act.

In other words, the disbursement quota for a public foundation is the total of the following amounts:

(a) Variables "A" and "A.1" are the same as above in relation to disbursement quota for charitable organizations.
(b) Variable "B" is 80% of all amounts received from other registered charities in its immediately preceding taxation year, other than specified gifts.[31]
(c) 4.5% of variable "D", having first deducted variables "E" and "F" from "D" (where variable "C" in the formula is the number of days in the taxation year).
(d) Variable "D" is the average value (i.e. the "prescribed amount") of assets of the public foundation in the immediately preceding 24 months that was not used directly in charitable activities or administration of the foundation. Sections 3700 to 3702 of the *Income Tax Regulations* provide a detailed mechanism to calculate the "prescribed amount" for purposes of calculating "D".
(e) Variable "E" is 5/4 of the total of "A" and "A.1" for the year, i.e. 100% of the amounts included when calculating "A" and "A.1" referred to above, rather than 80%.
(f) Variable "F" is 5/4 of "B", i.e. 100% of all amounts received from registered charities in its immediately preceding taxation year, other than specified gift.

Variable "G" refers to a defined amount in the first 10 taxation years of a public foundation commencing after 1983, and therefore is no longer relevant today.

iii) Private foundations

For a private foundation, the disbursement quota is the same as that for a public foundation, except:

[31] Summary Policy CSP – S12 dated September 3, 2003 indicates that a specified gift is "a gift from one registered charity to another, where the charities involved choose to make the transfer without affecting the disbursement quota of either charity." A gift becomes a specified gift if the transferor charity identifies it as such in its information return for the year. Information Circular RC 4108, entitled *Registered Charities and the Income Tax Act*, explains that the transferor charity cannot use a specified gift to satisfy its own disbursement quota. If the recipient charity is a charitable foundation, specified gifts received would not increase its disbursement quota. If the recipient charity is a charitable organization, it would not benefit from receiving a specified gift because it does not have to include gifts received from other registered charities.

(a) When calculating variable "B", 100% of all amounts received from a registered charity in its immediately preceding taxation year are included in the disbursement quota, rather than 80%.

(b) Variable "F" is the same as variable "B" (i.e. 100% of all amounts received from other registered charities in its immediately preceding taxation year), rather than 5/4 of "B" because 100% of the amounts has already been taken into account when calculating variable "B".

iv) Summary

The following table summarizes the disbursement quota rules that are in place prior to the proposed December 2004 Amendments:

Registered Charities	Disbursement Quota = A + A.1 + B + {C x 0.045 [D – (E + F)]}÷365 + G			
	"A"	"A.1"	"B"	{C x 4.5% [D – (E + F)]}÷365
Charitable Organizations	80% of the all amounts each of which the charity issued a donation receipt in its immediately preceding taxation year, other than: (a) a gift of capital received by way of bequest or inheritance; (b) a ten-year gift; and (c) a gift received from another registered charity	80% of the amounts that are (1) gifts of (i) capital received by way of bequests or inheritance for taxation years that begin after 1993 and (ii) ten-year gifts whenever received, (2) have previously been excluded from the charity's disbursement quota when calculating "A", and (3) are spent by the charity in the year	N/A	N/A
Public Foundations	same as above	same as above	80% of all amounts received from other registered charities in its immediately preceding taxation year, other than specified gifts	4.5% of ["D" - "E" – "F"] "D" = average value of assets of the foundation in the immediately preceding 24 months that were not used directly in charitable activities or administration of the foundation "E" = 5/4 of ("A" + "A.1") = 100% of ("A" + "A.1") "F" = 5/4 of "B" = 100% of all amounts received from registered charities in its immediately preceding taxation year, other than specified gift
Private Foundations	same as above	same as above	Same as above, except 100%, rather than 80%	Same as above, except that "F" = "B", not 5/4 of "B"

b) Proposed new disbursement quota rules

The following new algebraic formula for disbursement quota is introduced by the September 2004 Amendments:

$$A + A.1 + A.2 + B + \{C \times 0.035 [D – (E + F)]\}/365$$

The following was introduced by the September 2004 Amendments:

(a) Variables “A”, “A.1”, “B”, “D”, “E”, and “F” have been redefined;

(b) New variable “A.2” has been introduced;

(c) 4.5% disbursement quota has been reduced to 3.5%; and

(d) New concepts of “enduring property” and capital gains pool” have been introduced.

In December 2004, the algebraic formula for calculating the disbursement quota was revised as follows:

A + A.1 + B + B.1 (where B.1 = C x 0.035 [D – (E + F)]/365)

The following changes have been made to the formula in December 2004:

(a) Amending the definition for variable “A.1” by inserting a new subparagraph (a)(ii) and by amending paragraph (b);

(b) Including a *de minimus* threshold of $25,000 for variable “D”;

(c) Amending the definition for variable “E”;

(d) Removing variable “A.2” and

(e) Simplifying the formula by defining “B.1,” which is equal to C x 0.035 [D – (E + F)]/365).

The implications of the above changes are commented upon below.

c) Reduction of disbursement quota rate

The December 2004 Amendments propose to reduce the 4.5% disbursement quota, that applies to public and private foundations to a more manageable rate of 3.5%. Apparently, the formula that is used by the Department of Finance for the December 2004 Amendments is based on the current real rate of return minus 20% attributable to administrative costs. The March 2004 Budget indicates that the rate is to be reviewed periodically to ensure that it continues to be representative of long-term rates of return. However, this flexibility has not been built into the new disbursement quota formula in the Act. This would mean that changes in the economy in future that may again lead to the impracticality of the 3.5% disbursement would necessitate future amendments to the Act. In the event that a registered charity is not able to meet the reduced 3.5% disbursement quota, it can still apply for dispensation to reduce the disbursement quota in accordance with subsection 149.1(5) of the Act. The reduction of the 4.5% disbursement quota to 3.5% applies to taxation years that begin after March 22, 2004.

d) Extension of 3.5% disbursement quota to charitable organizations

Prior to the proposed amendments, only public and private foundations are subject to a disbursement quota upon its capital assets not used in charitable activities or administration. However, the December 2004 Amendments propose that the reduced 3.5% disbursement quota on capital assets also apply to charitable organizations. This amendment is achieved by changing the reference to “public foundation” or “charitable foundation” in the definition for disbursement quota in subsection 149.1(1) to “registered charity” and inserting references to “charitable organization” where applicable. The reduced 3.5% disbursement quota will apply to public and private foundations with taxation years that being after March 22, 2004. For charitable organizations registered after March 22, 2004, however, the 3.5% disbursement quota will apply to their taxation years that begin after March 22, 2004. For charitable organizations registered before March 23, 2004, the 3.5% disbursement quota will apply to their taxation years that begin after 2008.

Paragraph 149.1(2)(b), dealing with the circumstances under which the charitable status for charitable organizations may be revoked, has also been amended to reflect that the 3.5% disbursement quota applies to charitable organizations. Alternate wording for paragraph 149.1(2)(b) has also been introduced to deal with the transaction period for charitable organizations between 2004 and 2008.

However, the September 2004 Amendments failed to amend paragraph 149.1(21)(c) regarding “disbursement excess” for charitable organizations to provide a corresponding amendment (“disbursement excess” is the amount by which a registered charity’s expenditure in the year exceeds its disbursement requirements for the year). As a result, in December 2004, an amendment to paragraph 149.1(21)(c) was introduced to reflect the changes to the calculation of disbursement quota.

With the removal of this key distinction between charitable organizations and foundations, there will be little functional difference between the two, other than the 50% income disbursement rules. It would therefore not be surprising if the Department of Finance, as a matter of policy, eventually eliminates the distinction between charitable organizations and foundations altogether so that there would be only two categories of charities, i.e. charities and private foundations. It will be interesting to see what may transpire in this regard over the next few years.

e) De minimus threshold on the application of the 3.5% disbursement quota

One of the most significant changes brought by the September 2004 Amendments is the reduction of the 4.5% disbursement quota on investment assets of a registered charity to 3.5%, and the application of the reduced 3.5% disbursement quota to all registered charities (including charitable organizations), rather than only to charitable foundations. As a result of the application of the 3.5% disbursement quota to charitable organizations, concerns were raised in the charitable sector regarding the ramifications of the application of this requirement on small charitable organizations. In response to this concern, in December 2004, it was proposed that the reduced 3.5% disbursement quota only apply to registered charities (including charitable organizations, public foundations and private foundations) if the amount of their investment assets calculated under variable "D" of the disbursement quota formula is greater than $25,000. Where the amount of investment assets is equal to or less than $25,000, variable "D" would be nil.

f) New concept of "enduring property"

The December 2004 Amendments introduce a new concept of "enduring property" and propose to amend the amount for variable "A" when calculating the disbursement quota to include 80% of the total of the eligible amounts of gifts for which the charity issued donation receipts in its immediately preceding taxation year, other than the following gifts that are:

(a) enduring property; or

(b) received from another registered charity.

The proposed definition for "enduring property" in subsection 149.1(1) will include the following:

(a) a gift received by the charity by way of a bequest or inheritance, including a gift deemed by subsection 118.1(5.2) or (5.3) of the Act [32];

(b) a gift received by a charitable organization from another registered charity, where the majority of directors and trustees of the donor charity deal at arm's length with the recipient charitable organization, provided that the gift is subject to a trust or direction requiring that the gift be utilized over a period not exceeding five years in the course of a program of charitable activities or for the purpose of acquiring a capital property to be used directly in the charitable activities (this paragraph was not included in the September 2004 Amendments, but was inserted in December 2004);

(c) a ten-year gift received by the charity (i.e. the "original recipient charity") with the gift, or property substituted for the gift, subject to a trust or direction that the property is to be held by the original recipient charity or by another registered charity (i.e. "transferee") for a period of not less than 10 years from the date the original recipient charity received the gift, except that the trust or direction may permit the original recipient charity or the transferee to expend the property before the end of 10 years to the extent permitted under the definition for disbursement quota in order to meet the disbursement quota requirement (In December 2004, this paragraph was revised to clarify that paragraph (c) does not deal with gifts received from another registered charity); and

(d) a gift received by the charity as a transferee of an enduring property under (a) or (c) above from either an original recipient charity or another transferee charity, provided that if it is an enduring property under (c), the gift is subject to the same terms and conditions under the trust or direction. (The English version of the amendments proposed in December 2004 erroneously made reference to paragraph (b) instead of (c). However, the French version is correct. It is anticipated that this error will be corrected by a technical bill to be introduced at a later time.)

[32] Details regarding amendments to subsection 118.1(5.2) and (5.3) of the Act concerning gifts of life insurance proceeds, registered retirement income fund and registered retirement savings plan as a result of direct beneficiary designation are explained in Section f)v) below.

The new definition applies in respect of taxation years that begin after March 22, 2004. The following are several observations regarding the new concept of "enduring property":

i) New broad concept

The term "enduring property" is very broad and includes gifts of bequest or inheritance and ten-year gifts that are included in the formula for variable "A" prior to the proposed amendments, as well as life insurance proceeds, registered retirement income fund and registered retirement savings plan as a result of direct beneficiary designation, gifts received by a charitable organization from another registered charity to be expended in the next 5 years or less in its charitable activities, and gifts received by the charity as a transferee of an enduring property that are gifts by way of bequest or inheritance and ten-year gifts from either an original recipient charity or another transferee charity, provided that if the gift is a ten-year gift, the gift is subject to the same terms and conditions under the trust or direction.

ii) Gifts by way of bequest or inheritance: income vs. capital

In relation to gifts received by a charity by way of bequest or inheritance, these gifts will no longer be limited to "gifts of *capital* received by way of bequests or inheritance" [emphasis added] under the definition of disbursement quota prior to the proposed amendments. This means that a testamentary income interest received by a charity would now be included as part of an enduring property.

iii) Gifts received by charitable organizations from other registered charities to be expended in the next 5 years or less

In December 2004, a new category of enduring property was included in paragraph (b) for a gift received by a charitable organization from another registered charity, where the majority of directors and trustees of the donor charity deal at arm's length with the recipient charitable organization, provided that the gift is subject to a trust or direction requiring that the gift be utilized over a period not exceeding five years in the course of a program of charitable activities or for the purpose of acquiring a capital property to be used directly in the charitable activities. It appears that this provision is intended to provide a relief provision for charitable organizations.

iv) Ten-year gifts subject to ability to encroach

The definition of “enduring property” will also permit ten-year gifts that are subject to trusts or directions that may permit the original recipient charity or the transferee to expend the ten-year gifts before the end of 10 years to the extent permitted under the definition for disbursement quota in order to meet the disbursement quota requirement. Our comments concerning the limit on the encroachment is set out in Section g) below.

v) Gifts made by way of direct designation

As a result of amendments to the Act introduced by the 2000 Federal Budget, payments of life insurance proceeds [paragraph 118.1(5.2)], registered retirement income fund or registered retirement savings plan [paragraph 118.1(5.3)] as a result of direct beneficiary designation were deemed to be gifts for the purposes of section 118.1 in respect of deaths that occur after 1998, provided that requirements under subsections 118.1(5.1), (5.2) and (5.3) are met. As such, upon the death of an individual, a charitable donation tax receipt can be provided to the estate and the executor can claim the donation tax credit on the deceased’s terminal income tax return. However, CRA’s technical interpretation document number 2002-0133545 dated January 16, 2003 confirms that “these payments have not been deemed to be gifts for purposes other [than] section 118.1, they are not gifts for purposes [of] the calculation of the DQ pursuant to the definition in subsection 149.1(1) of the Act and, therefore, are not included therein.”[33]

The December 2004 Amendments address this issue by amending subsections 118.1(5.2) and (5.3) and the definition of enduring property, by including these gifts as enduring property, and therefore are included in the calculation of the disbursement quota. These gifts will be subject only to the 3.5% disbursement quota while they are held as capital by the charity and will then become subject to the 80% disbursement quota requirement in the year in which they are disbursed. This amendment applies in respect of deaths after 1998, which retroactivity may

[33] See also CRA’s *Registered Charities Newsletter*, dated April 2, 2003.

lead to hardship for charities that relied on the earlier position of CRA that such direct designation would not be included in the charities' disbursement quota from the enactment of subsections 118.1 (5.1) to (5.3) in 2000 to the present.

vi) Transfer of ten-year gifts

Paragraph (d) of the definition for "enduring property" will permit a ten-year gift to be transferred to another registered charity during the ten-year period as if the ten-year gift had been received directly from the original donor, without the amount transferred affecting the disbursement quota for both the transferor charity and the recipient charity. This is further explained in Section h) below concerning inter-charity transfers.

g) Encroachment of enduring property

Prior to the proposed amendments, variable "A.1" of the disbursement quota requires the inclusion of gifts received by a charity by way of bequest or inheritance or ten-year gifts that have previously been excluded in the calculation of disbursement quote under variable "A" in the year they are expended. As explained in the March 2004 Budget, since an annual disbursement quota is applied to funds held by charities, sometimes, charities may prefer to meet its obligations to satisfy the disbursement quota by realizing capital gains rather than disbursing investment income earned from these funds, especially where the return on the investment is weighted heavily in favour of capital gains. However, "if the charity does so, . . . it must then meet an 80 per cent disbursement obligation to the extent that the proceeds of disposition are expended by the charity."[34]

The difficulty caused the wording in the Act is addressed by the September 2004 Amendments by amending variable "A.1" of the disbursement quota by allowing the charity to encroach on the capital gains of enduring property up to a maximum of the "capital gains pool" of the charity, which is another concept introduced by the September 2004 Amendments. In this regard, in the September 2004 Amendments, variable "A.1" is proposed to be defined to be equal to 80% of the amount by which the total amount of enduring property owned by the charity to the extent that it is expended

[34] See the March 2004 Budget.

in the year exceeds the lesser of (i) 4.375 per cent (i.e. 5/4 of 3.5%) of the amount determined for variable "D" and (ii) the capital gains pool of the charity for the taxation year. The definition for "A.1" has been amended in December 2004 by inserting a new subparagraph (a)(ii) to include the fair market value of enduring property transferred by the charity in the year by way of gift to a qualified donee. This does not include enduring property that was received by the charity as a specified gift. The new subparagraph (a)(ii) is the same as the definition for "A.2" that was removed in December 2004. Further, paragraph (b) of "A.1" is amended to clarify that the amount calculated under subparagraph (a) is reduced by an amount "claimed by the charity" that may not exceed the lesser of 3.5% of the investment assets of the charity and the capital gains pools of the charity. The phrase "an amount claimed by the charity" in paragraph (b) in the definition for "A.1" would have the effect of permitting the charity to decide whether to encroach on the capital gains pool and, if so, how much to encroach. This amendment also means that the amount formerly determined under "A.2" in the September 2004 Amendments will also become eligible for capital gains reduction. As well, as a result of the amendment to "A.1" and the removal of "A.2", the definition for "E" is also similarly amended in December 2004.

As a result, 80% of enduring property expended by the charity under subparagraph (a)(i) and the full fair market value of enduring property transferred by the charity to a qualified donee under subparagraph (a)(ii) would be added together, and reduced by the amount claimed by the charity under paragraph (b) that may not exceed the lesser of 3.5% of the investment assets of the charity under variable "D" and the capital gains pool of the charity.

This proposal will apply to taxation years that begin after March 22, 2004. It is important to note the following in relation to the new definition of variable "A.1":

i) Limit on encroachment

This formula permits expenditure of enduring property provided that the expenditure is the amount claimed by the charity under paragraph (b) of "A.1" that may not exceed the lesser of 3.5% of the investment assets of the charity under variable "D" and the capital gains pool of the charity.

(1) Calculation of variable "D"

The calculation for the amount for variable "D" remains substantially the same as the definition prior to the proposed amendments save and except the *de minimus* threshold of $25,000 mentioned above, i.e. the average value (i.e. the "prescribed amount") of assets of the charity in the 24 months immediately preceding that taxation year that was not used directly in charitable activities or administration of the charity if the amount of the investment assets calculated under variable "D" of the disbursement quota formula is greater than $25,000. Where the amount of investment assets is equal to or less than $25,000, variable "D" would be regarded as nil. The reference to variable "D" for purposes of calculating the limit on the encroachment does not take into account the variables "E" or "F" as required when calculating the 3.5% disbursement quota as described in the formula $\{C \times 0.035 [D – (E + F)]\}/365$.

(2) "Capital gains pool"

The new definition "capital gains pool" applies for the purpose of the definition "disbursement quota", applicable to taxation years that begin after March 22, 2004. The original definition for "capital gains pool" in the September 2004 Amendments provides that generally, the capital gains pool of a registered charity for a taxation year is the total of all capital gains of the charity from the disposition of enduring properties after March 22, 2004, less the total disbursement requirement of the charity under variable "A.1" of the definition for disbursement quota in respect of the expenditure of such enduring properties in a preceding taxation year that began after March 22, 2004. This definition is modified in December 2004 to provide that the capital gains pool for a taxation year is the total of all capital gains of the charity from the disposition of enduring properties after March 22, 2004, as declared by the charity in its T3010 Information Return for the taxation year during which the disposition occurred, that exceeds the lesser of the following two amounts set out in paragraph (b) in the definition for "capital gains pool":

(i) The amount determined according to paragraph (a) of variable “A.1”, i.e. the total of 80% of enduring property expended by the charity under subparagraph (a)(i) and the full fair market value of enduring property transferred by the charity to a qualified donee under subparagraph (a)(ii); and

(ii) The amount claimed by the charity according to paragraph (b) of variable “A.1”, i.e. the amount claimed by the charity that may not exceed the lesser of 3.5% of the charity’s investment assets and its capital gains pool.

The capital gains from a disposition of a bequest or inheritance received by the charity before 1994 is not included. It is important to note that the capital gains pool only consists of all capital gains realized by the disposition of enduring property, rather than accrued gains. Further, the concept of the “capital gains pool” appears to be based on a tax policy in imposing an arbitrary cap on the ability of charities to encroach on testamentary gifts and ten-year gifts in order to meet the 3.5% disbursement quota, instead of being able to encroach up to the amount required to satisfy the 3.5% disbursement quota.

The December 2004 Amendments require that the total of all capital gains of the charity from the disposition of enduring properties must be “declared by the charity” in its T3010 Information Return “for the taxation year during which the disposition occurred.” The Explanatory Notes to the December 2004 Amendments indicate that “annual calculation of additions to and deductions from the capital gains pool is voluntary; however, it may be of benefit to a charity to make this calculation if it expects ever to claim a reduction of its disbursement quota in respect of the expenditure of enduring property.” In other words, in practice, whether or not a charity expects to encroach on its capital gains pool in the year, it should conduct its annual calculation and declare the amount of all capital gains of the charity from the disposition of enduring properties on an annual basis and declare the same in its T3010 Information Return in order to be able to encroach on its capital gains pool if and when it is required to do so in the future.

As indicated above, the phrase "an amount claimed by the charity" in paragraph (b) in the definition for "A.1" would have the effect of permitting the charity to decide whether to encroach on the capital gains pool and, if so, how much to encroach.

As can be seen from the amended definition, the calculation of the capital gains pool is very complicated.

ii) Exclusion of certain enduring property

When calculating variable "A.1", the following enduring properties will not be included:

(a) enduring properties included in paragraph (a)(ii) in the definition for "A.1";
(b) enduring properties received by the charity as "specified gifts," and
(c) a bequest or an inheritance received by the charity in a taxation year that included any time before 1994.

The above exceptions in relation to enduring properties included in paragraph (a)(ii) in the definition for "A.1" and "specified gifts" are commented upon in Section h) below concerning inter-charity transfers.

iii) Gifts received and spent in the same year

Prior to the proposed amendments, long-term gifts (i.e. ten-year gifts and gifts received by way of bequest or inheritance) are subject to an 80% disbursement quota to the extent that the registered charity liquidates and spends the capital in the year following the year in which the gift is received. The rules prior to the proposed amendments, however, do not address the situation where the charity receives a long-term gift and disburses it in the same year. The December 2004 Amendments eliminate this loop-hole by removing the requirement under the calculation of variable "A.1" gifts that have previously been excluded from the charity's disbursement quota. As such, it applies the 80% disbursement quota to gifts that are expended in the same year that they are received.

h) Inter-charity transfer

i) Gifts transferred to charitable organizations

Prior to the proposed amendments, only transfers from registered charities to public and private foundations are subject to the 80% disbursement quota, which mean that transfers from registered charities to charitable organizations are exempt from the 80% disbursement quota. The December 2004 Amendments propose that all transfers from one registered charity to another, including transfers to charitable organizations, will be subject to the 80% disbursement requirement. The only exceptions are transfers involving specified gifts and enduring property. This is achieved by applying variable "B" to charitable organizations. Variable "B" is now defined to mean as follows:

(a) in the case of private foundations, variable "B" is the total of all amounts received by it in its immediately preceding taxation year from a registered charity, other than specified gifts or enduring properties; and

(b) in the case of charitable organizations and public foundations, variable "B" is the same as the case for the private foundation, except that the inclusion rate is 80%, rather than 100%.

This means that gifts of enduring property received from another registered charity will no longer be subject to the disbursement quota of the recipient charity in the year after the year in which it is received. Such gifts will be subject to the same requirements as those that apply to gifts of enduring property received from other persons. The exception for a "specified gift" will continue to apply. These changes will apply to transfers received by charitable organizations in taxation years that begin after March 22, 2004.

ii) Transfer of ten-year gifts

Due to a drafting error in the definition of the disbursement quota in the Act prior to the proposed amendments, if a charity transfers a ten-year gift to another charity, the transferee charity has to expend 80% of the ten-year gift in the year following the transfer of the gift. In order to avoid the recipient charity having to include the amount it received in its disbursement quota and having to expend 80% of the amount in the following year, the recipient charity is required to recognize the amount received as a specified gift. However, in order for the amount transferred to be recognized as a specified gift, the amount has to be designated as such by the transferor charity. The disposition of the property as a specified gift by the transferor charity means that the transferor charity is not permitted to include the amount transferred in meeting its disbursement quota to off-set the inclusion of the amount transferred in the calculation of the disbursement quota as a result of the expenditure of the ten-year gift. To overcome this difficulty, the transferor charity or the transferee charity would have to obtain relief from CRA by applying for dispensation from the application of the disbursement quota under subsection 149.1(5) of the Act.

In order to address this anomaly, the September 2004 Amendments propose to exempt the transfer of enduring property from variable "B". The effect of this would be that a gift of enduring property received by a charity would not need to be included in the disbursement quota of the recipient charity. This exemption, therefore, would not require that the enduring property received be expended in the following year by the recipient charity. With respect to the transferor, this anomaly is proposed to be resolved in the September 2004 Amendments by a new variable "A.2", which is defined in paragraph 149.1(1) to mean the fair market value (at the time of the transfer) of enduring property (other than enduring property that was received by the charity as a specified gift) transferred by a charity in the taxation year by way of gift to a qualified donee. In December 2004, variable "A.2" was removed and a new subparagraph (a)(ii) was inserted in the definition for "A.1" to include the fair market value of enduring property transferred by the charity in the year by way of gift to a qualified donee (which does not include enduring property that was received by the charity as a specified gift). The new subparagraph (a)(ii) is the same as the definition for "A.2" that was removed in December 2004. This amendment means that the amount formerly determined under "A.2" in the September 2004 Amendments will also become eligible for capital gains reduction.

In this regard, the Explanatory Notes indicate that a different disbursement requirement applies for an enduring property that is expended by way of gift to a qualified donee. The charity must disburse 100% of such an amount (which requirement is satisfied by the gift itself). This means that the transferor charity would be able to include the amount of enduring property it transfers to a qualified donee in order to meet its disbursement quota requirement, which would off-set the increase in disbursement quota of the transferor charity as a result of disposing of the enduring property to the qualified donee. This proposal also applies to taxation years after March 22, 2004.

If the enduring property being transferred was inadvertently designated by the transferor charity as a specified gift, such designation would not cause any negative effect on the disbursement quota on the recipient charity because variable “B” also exempts specified gifts received by the charity from being included in the recipient charity’s disbursement quota. However, such a designation would lead to an unintended negative effect on the disbursement quota of the transferor charity, because the disposal of a specified gift is not exempt from subparagraph (a)(ii) was inserted in the definition for “A.1” and, therefore, the amount must be included in the disbursement quota of the transferor charity, leading to the same unfavourable result caused by the drafting error in the Act prior to the proposed amendments.

iii) Transfer as a result of penalty

The Explanatory Notes indicate that subsection 149.1(1.1) of the Act provides that a gift or expenditure made by a registered charity will not be considered in determining whether it has met its annual disbursement quota if the gift is made by way of a specified gift or if the expenditure is on political activities. Subsection 149.1(1) will be amended by the September 2004 Amendments, consequential to the amendment of Part V of the Act in respect of taxes and penalties for which the charity is liable under subsection 188(1.1) or section 188.1 of the Act. Now paragraph 149.1(1.1)(c) provides that a transfer to another registered charity under that Part does not qualify as an expenditure for the purposes of calculating the transferor’s disbursement quota. This amendment will apply in respect of notices of intention to revoke the registration of a charity and to notices of assessment issued by the Minister after the day that is 30 days after Royal Assent.

i) Summary of the proposed new disbursement quota rules

The following is a summary of the new disbursement quota rules set out in the December 2004 Amendments:

Registered Charities	Proposed Disbursement Quota = A + A.1 + B + B.1			
	“A”	“A.1”	“B”	B.1
Charitable Organizations and Public Foundations	80% of all eligible amount of gifts for which the charity issued donation receipts in its immediately preceding taxation year, other than: (a) gifts of enduring property; (b) gifts received from other registered charities. “Enduring properties” include properties that are: (a) gifts of bequest or inheritance, including life insurance proceeds, RRSPs, and RRIFs by direct beneficiary designation (b) gifts received by a charitable organization from another registered charity, where the majority of directors and trustees of the donor charity deal at arm’s length with the recipient charitable organization, provided that the gift is subject to a trust or direction requiring that the gift be utilized over a period not exceeding five years in the course of a program of charitable activities or for the purpose of acquiring capital property to be used directly in the charitable activities (Note that this paragraph does not apply to gifts received by public foundations) (c) ten-year gifts (d) gifts received by the charity as a transferee of enduring property that are gifts of bequest or inheritance and ten-year gifts from either an original recipient charity or another transferee charity, provided that if the gifts are ten-year gifts, the gifts are subject to the same terms and conditions under the trust or direction	The amount by which (a) the total of (i) 80% of the amount by which the total amount of enduring property owned by the charity to the extent that they are expended in the year, and (ii) the fair market value (at the time of the transfer) of enduring property (other than enduring property that was received by the charity as a specified gift) transferred by the charity in the taxation year by way of gift to qualified donees exceeds (b) the amount claimed by the charity that may not exceed the lesser of (i) 3.5% of the amount determined for “D” and (ii) the capital gains pool of the charity for the taxation year (defined in the note to the table) NOTE: “Enduring property” not included in subparagraph (a)(i) of “A.1” = (a) enduring properties described in subparagraph (a)(ii) of “A.1” ; (b) enduring properties received by the charity as “specified gifts”; and (c) bequests or inheritance received by the charity in a taxation year that included any time before 1994	80% of all amounts received from other registered charities in its immediately preceding taxation year, other than specified gifts and enduring property	B.1 = C x 0.035 [D – (E + F)]/ 365 “C” = number of days in the taxation year “D” = (a) average value of the charity’s assets in the 24 months immediately preceding the taxation year that were not used directly in charitable activities or administration of the charity, if that amount is greater than 25,000 (b) in any other case, it is nil “E” = “A.1”(a)(ii) + 5/4 of (“A” + “A.1”(a)(i)) “F” = 5/4 of “B” which is = 100% of all amounts received from registered charities in its immediately preceding taxation year
Private Foundations	same as above	same as above	Same as above, except 100%, rather than 80%	Same as above, except that “F” = “B”, not 5/4 of “B”
NOTE: “Capital gains pool” of a registered charity for a taxation year = the total of all capital gains of the charity from the disposition of enduring properties after March 22, 2004 that are declared by the charity in its T3010 Information Return for the taxation year during which the disposition occurred, that exceeds the lesser of the following two amounts: • The amount determined according to paragraph (a) of variable “A.1”, i.e. the total of 80% of enduring property expended by the charity under subparagraph (a)(i) and the full fair market value of enduring property transferred by the charity to a qualified donee under subparagraph (a)(ii). • The amount claimed by the charity according to paragraph (b) of variable “A.1”, i.e. the amount claimed by the charity that may not exceed the lesser of 3.5% of the charity’s investment assets and its capital gains pool. However, the capital gain from the disposition of a bequest or inheritance received by the charity before 1994 is not included.				

The above is a summary of the proposed new rules regarding disbursement quota for charities. Although many aspects of the proposed new rules reflect a bona fide attempt by the Department of 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. Even with a more detailed Disbursement Quota Worksheet for the Registered Charity Information Return - T3010A to assist in the annual calculation of the disbursement quota, charities will still be left in a vulnerable position. This is because charities not only need to be able to compute the disbursement quota at their fiscal year end for purposes of completing their T3010A, they also need to have a good working knowledge of the computation of the disbursement quota that they are required to satisfy in order to enable them to make informed decisions when planning their receipt and disbursement of funds throughout the year so that their decisions will not negatively impact their ability to meet their disbursement quota requirements.

In addition, there are concerns about the application of the proposed 3.5% 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 is a major change in tax policy by the Department of Finance that would blur the line between public foundations and charitable organizations to the point that the need for public foundations may be eliminated all together, leaving only charitable organizations and private foundations.

E. CONCLUSION

In general, the extensive legislative reform proposed represents significant improvements over a number of problems associated with the tax rules concerning registered charities in Canada, such as the curtailing of tax shelter donation schemes, intermediate sanction rules, restrictions on trading charitable donations, a new appeals regime and revisions to the calculation of the disbursement quota that applies to gifts received by registered charities. However, the new disbursement rules are very complex and may leave many registered charities, as well as their advisors, confused about how to implement the new provisions on both a day-to-day basis and in completing their T3010 Information Returns. In addition, the effective date for the many amendments varies greatly, some being retroactive to as early as December 2002, while some provisions will not be in effect until 2008, possibly creating yet more confusion. The complex nature of the various amendments requires that charities take steps now to become familiar and comply with those amendments.

CARTERS.ca™

CARTER & ASSOCIATES
PROFESSIONAL CORPORATION
BARRISTERS, SOLICITORS & TRADE-MARK AGENTS
Affiliated with **Fasken Martineau DuMoulin** LLP

Main Office Location
211 Broadway, P.O. Box 440
Orangeville, ON, Canada, L9W 1K4
Tel: (519) 942-0001
Fax: (519) 942-0300
Toll Free: 1-877-942-0001
www.carters.ca™

National Meeting Locations
Toronto (416) 675-3766
Ottawa (613) 212-2213
London (519) 937-2333
Vancouver (877) 942-0001
"Proactive Advice" ®
www.charitylaw.ca™