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**DECEMBER 2004 AMENDMENTS TO THE *INCOME*  
TAX ACT AFFECTING CHARITIES**

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**A. INTRODUCTION**

Draft amendments to the *Income Tax Act* (the “Act”) implementing the March 2004 Federal Budget (“2004 Budget”) were released on September 16, 2004 (“September 2004 Amendments”), and further amended and consolidated 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* received its first reading on December 8, 2004 and on December 14, 2004, it was moved to be read a second time and referred to a committee. These amendments introduced a new regulatory regime for charities, new intermediate sanctions, a more accessible appeals regime, improved transparency and more accessible information, as well as new disbursement quota rules for charities. The proposed September 2004 Amendments have already been explained in *Charity Law Bulletin* Nos. 54, 55, 56 and 59,<sup>1</sup> which should be referred to in conjunction with reading this *Charity Law Bulletin*. This *Charity Law Bulletin* provides a summary of the proposals in the December 2004 Amendments that vary from the September 2004 Amendments.

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<sup>1</sup> See *Charity Law Bulletin* No. 54 dated October 29, 2004, *Charity Law Bulletin* No. 55 dated October 30, 2004, *Charity Law Bulletin* No. 56 dated October 31, 2004, and *Charity Law Bulletin* No. 59, dated November 26, 2004, all of which are available on our website at [www.charitylaw.ca](http://www.charitylaw.ca).

## B. SUMMARY OF CHANGES IN THE DECEMBER 2004 AMENDMENTS

A summary of the changes in the December 2004 Amendments are set out below as follows:

### 1. Revisions to the disbursement quota formula

The algebraic formula for calculating the disbursement quota in the September 2004 Amendments was as follows:

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

In the December 2004 Amendments, the algebraic formula for calculating the disbursement quota has been revised as follows:

$$A + A.1 + B + B.1 \text{ (where } B.1 = C \times 0.035 [D - (E + F)]/365)$$

In summary, the following changes have been made to the formula by the December 2004 Amendments and details regarding these changes are set out below and in the table in section B.6. of this *Charity Law Bulletin*:

- ◆ Amending the definition for variable “A.1” by inserting a new subparagraph (a)(ii) and by amending paragraph (b);
- ◆ Including a *de minimus* threshold of \$25,000 for variable “D”;
- ◆ Amending the definition for variable “E”;
- ◆ Deleting variable “A.2” and
- ◆ Simplifying the formula by defining “B.1,” which is equal to  $C \times 0.035 [D - (E + F)]/365$ .

### 2. 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.<sup>2</sup> 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, the December 2004 Amendments 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.

3. Amendment of the definition for variable “A.1” and “E”, and removal of variable “A.2”

The definition for “A.1” has been amended 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 the December 2004 Amendments. 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 effect of this amendment is that the amount formerly determined under “A.2” in the September 2004 Amendments will also become eligible for capital gains reduction. In addition, the phrase “an amount claimed by the charity” in paragraph (b) would have the effect of permitting the charity to decide whether to encroach on the capital gains pool or not and, if so, how much to encroach. 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.

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<sup>2</sup> See pages 5 and 6 of *Charity Law Bulletin* No. 59 for a detailed explanation regarding the reduction of the 4.5% disbursement quota on investment assets of a registered charity to 3.5% and the application of the 3.5% disbursement quota to all registered charities.

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.

4. Expansion of “enduring property”

The September 2004 Amendments introduced a new concept of “enduring property” in subsection 149.1(1). The December 2004 Amendments further amend the proposed definition in the following two ways:

- ◆ A new paragraph (b) is proposed to be inserted to include 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.
- ◆ Paragraph (c) of the definition for enduring property has been amended to clarify that paragraph (c) does not deal with gifts received from another registered charity.

5. Amendments to the definition of capital gains pool

Charities will be able to utilize the capital gains pool in order to encroach on enduring property as described in the September 2004 Amendments. 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.

Further, paragraph (b) of the definition for capital gains pool is also amended. The September 2004 Amendments provide that 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 amount determined under paragraph (b) of variable “A.1” in the definition for disbursement quota for a preceding taxation year that began after March 22, 2004, i.e. the lesser of 3.5% of the charity’s investment assets and its capital gains pool for the taxation year. This is modified in the December 2004 Amendment 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:

- ◆ 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.

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

6. Summary of the proposed new disbursement quota rules

The following is a summary of the new disbursement quota rules as amended by 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	<p>80% of all eligible amount of gifts for which the charity issued donation receipts in its immediately preceding taxation year, other than:</p> <p>(a) gifts of enduring property;</p> <p>(b) gifts received from other registered charities.</p> <p>"Enduring properties" include properties that are:</p> <p>(a) gifts of bequest or inheritance, including life insurance proceeds, RRSPs, and RRIFFs by direct beneficiary designation</p> <p>(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)</p> <p>(c) ten-year gifts</p> <p>(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</p>	<p>The amount by which</p> <p>(a) the total of</p> <p>(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</p> <p>(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</p> <p>exceeds</p> <p>(b) the amount claimed by the charity that may not exceed the lesser of</p> <p>(i) 3.5% of the amount determined for "D" and</p> <p>(ii) the capital gains pool of the charity for the taxation year (defined in the note to the table)</p> <p>NOTE:</p> <p>"Enduring property" not included in subparagraph (a)(i) of "A.1" =</p> <p>(a) enduring properties described in subparagraph (a)(ii) of "A.1" ;</p> <p>(b) enduring properties received by the charity as "specified gifts"; and</p> <p>(c) bequests or inheritance received by the charity in a taxation year that included any time before 1994</p>	<p>80% of all amounts received from other registered charities in its immediately preceding taxation year, other than specified gifts and enduring property</p>	<p><math>B.1 = C \times 0.035 [D - (E + F)] / 365</math></p> <p>♦ "C" = number of days in the taxation year</p> <p>♦ "D" =</p> <p>(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</p> <p>(b) in any other case, it is nil</p> <p>♦ "E" = "A.1"(a)(ii) + 5/4 of ("A" + "A.1"(a)(i))</p> <p>♦ "F" = 5/4 of "B" which is = 100% of all amounts received from registered charities in its immediately preceding taxation year</p>
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"

Registered Charities	Proposed Disbursement Quota = A + A.1 + B + B.1			
	"A"	"A.1"	"B"	B.1

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.

7. Revocation of charitable status that was obtained based on false information

The 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.<sup>3</sup> 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, the December 2004 Amendments 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 of National Revenue after the day that is 30 days after Royal Assent.

8. Revised definition of "disbursement excess"

Paragraph 149.1(2)(b), dealing with the circumstances under which charitable organizations may have their registration revoked, has been amended to reflect that the 3.5% disbursement quota applies to charitable organizations and to deal with the transaction period between 2004 and 2008 for charitable organizations registered before March 23, 2004. However, the September 2004 Amendments failed to

<sup>3</sup> See page 7 of *Charity Law Bulletin* No. 41, March 30, 2004.

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, the December 2004 Amendment introduced an amendment to paragraph 149.1(21)(c) to reflect the changes to the calculation of disbursement quota.

9. Reduction in time period used to assess repeat infractions.

The September 2004 Amendments introduced a new section 188.1 to put in place intermediate taxes and penalties to address the concern that the only recourse Canada Revenue Agency had in regard to a registered charity that did not comply with the requirements of the Act was to revoke its status as a registered charity. The Explanatory Notes to the September 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 within a period of 10 years” and the September 2004 Amendments introduced a ten-year period in this regard. However, the charitable sector was 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.<sup>4</sup> In response to this concern, the December 2004 Amendments proposed that 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)] be reduced from ten to five years. However, the Explanatory Notes to the December 2004 Amendments have not been up-dated to reflect this change.

10. Effective date for application of certain provisions

The effective date for the application of the following provisions was changed from notices issued by the Minister of National Revenue after the later of December 31, 2004 and 30 days after Royal Assent to notices issued after the day that is 30 days after Royal Assent:

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<sup>4</sup> See page 2 of *Charity Law Bulletin* No. 54 for details.



- ◆ subsections 149.1(1.1)(c) and 149.1(4.1) in relation to calculation of qualifying disbursements;<sup>5</sup>
- ◆ subsections 149.1(22), (23) and (24) in relation to refusal to register and annulment of registrations;<sup>6</sup>
- ◆ subsections 168(3) and (4), 172(3)(a) and (a.1), 172(4) and 180(1) in relation to objections and appeals;<sup>7</sup>
- ◆ subsections 188(1), (1.1), (1.2), (1.3), (2), and (2.1) in relation to revocation tax;<sup>8</sup> and
- ◆ subsections 189(6.1), (6.2), (6.3), (7), (8), (8.1) and (9) in relation to revocation and revocation tax.<sup>9</sup>

As well, the effective date for paragraphs 241(3.2)(e) to (h) in relation to disclosure of information by Canada Revenue Agency to the public has also be amended to apply to documents that are sent by the Minister of National Revenue, or that are filed or required to be filed with the Minister, after the day that is 30 days after Royal Assent.

11. Eligible donees must be registered charities

The definition for “eligible donees” set out in subsection 188(1.3) in the September 2004 Amendments “assumes” that an eligible donee must be a registered charity, without this being a requirement under that subsection. This subsection in the December 2004 Amendments now requires that an “eligible donee” must be a “registered charity” that satisfies five criteria set out in paragraphs 188(1.3)(a) to (e).

12. Applicable provisions upon the filing of notice of objection

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 modified by the December 2004 Amendments 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

<sup>5</sup> See *Charity Law Bulletin* No. 59 for details.

<sup>6</sup> See *Charity Law Bulletin* No. 55 for details.

<sup>7</sup> See *Charity Law Bulletin* No. 56 for details.

<sup>8</sup> See *Charity Law Bulletin* No. 55 for details.

<sup>9</sup> See *Charity Law Bulletin* No. 54, and No. 55 for details.

(1.11), (1.12), (1.13), (1.14), (1.15), (1.2), and (2.1) would not apply, and subsection (7) would apply instead.

### C. CONCLUSION

The December 2004 Amendments represent significant improvements over a number of problems associated with the September 2004 Amendments. However, the new disbursement rules are still very complex and will leave many registered charities, as well as their advisors, possibly confused about how to implement the new provisions on both a day-to-day basis, as well as in completing their T3010 Information Returns.



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