
QUICK LIST OF NEW TAX RULES FOR CHARITIES

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A. INTRODUCTION

Over the past year, there have been a number of important changes to tax rules affecting many aspects of operations of charities in Canada. This *Bulletin* is intended to provide a quick summary of these changes as a resource tool and does not contain any detailed explanation or analysis.

Firstly, sweeping amendments to the *Income Tax Act* (Canada) (the “Act”) were enacted by Bill C-33, *A Second Act to Implement Certain Provisions of the Budget Tabled in Parliament on March 23, 2004*, which came into force on May 13, 2005.¹ These changes include a reduced disbursement quota rate and calculation formula, the ability to encroach on realized capital gains of enduring property, complicated rules regarding inter-charity transfers, and new intermediate sanctions and penalties for minor non-compliance of requirements on charities under the Act, among others.

Secondly, on July 18, 2005, the Department of Finance again released legislative proposals to amend the Act. The July 2005 proposal is a package of changes that consolidates and further amends previously proposed amendments introduced in 2002, 2003 and 2004.² These changes include split-receipting, designation of charitable organizations and public foundations, and revocation of charitable registrations, to name a few.

B. QUICK LIST OF CHANGES ENACTED BY BILL C-33 IN MAY 2005

The following is a list of the changes enacted by Bill C-33, which is in effect as of May 13, 2005:

- The 4.5% disbursement quota is reduced to 3.5%.
- The 3.5% disbursement quota is extended to charitable organizations for their taxation years that begin after March 22, 2004, except that for charitable organizations registered before March 23, 2004, the 3.5% disbursement quota applies to their taxation years that begin after 2008.
- The 3.5% disbursement quota does not apply where the amount of investment assets is equal to or less than \$25,000.
- Gifts transferred to charitable organizations from other registered charities are now subject to the 80% disbursement quota.
- The 80% disbursement quota can be delayed through a transfer of “enduring property” to a charity. Enduring property includes (1) ten-year gifts, (2) five-year gifts received by a charitable organization from another registered charity, (3) gifts of life insurance proceeds, registered retirement income funds or registered retirement savings plans as a result of direct beneficiary designation, and (4) inter-charity transfers of (1) and (3) above.
- Inter-charity transfers have become more complicated.
- Failure to comply with rules for registered charities under the Act can result in intermediate sanctions and penalties against charities, without their charitable status being revoked at the first instance.
- The conferment of “undue benefit” by a charity or by another person at the direction or with the consent of the charity, on any person will lead to intermediate penalties for the charity in question.
- New internal appeals process is now available on certain matters. As well, the external process for appeals of taxes and penalties to the Tax Court of Canada has been extended to charities.
- Canada Revenue Agency (“CRA”) now has the explicit authority for the Minister to annul an organization’s charitable registration if it determines that the charity was registered in error or if it has ceased to be a charity solely as a result of a change in law.
- There are new rules for the calculation of the revocation tax.
- There are new rules to ensure that unused charitable donation deductions cannot be traded.

C. QUICK SUMMARY OF CHANGES PROPOSED ON JULY 18, 2005

The following is a list of the changes proposed on July 18, 2005:

- New split-receipting rules will apply that would allow a donor to receive a limited advantage in respect of a gift having been made.
- The broad definition of “advantage” may reduce the eligible amount of a charitable receipt.
- Complicated new rules to curtail tax shelter schemes may result in reduction of the eligible amount on charitable receipts for gifts in kind.
- Where (1) donated property was acquired by the donor through a tax shelter arrangement regardless of when it was acquired, or (2) donated property was acquired by the donor less than 3 years before making the gift, the value of the donated property would be “deemed” to be the lesser of (i) the fair market value otherwise determined and (ii) the cost of the property to the donor immediately before making the gift.
- Where donated property was acquired less than 10 years before making the gift, and where it is “reasonable to conclude” that one of the main reasons for acquiring the property was to make a gift to a qualified donee, the deeming provision also applies.
- The acquisition of a donated property by a person or a partnership dealing non arm’s length with the donor within the said 3-year or 10-year hold periods would also impact how the fair market value of the donated property is determined.
- Charities will need to make “reasonable inquiries” of donors before issuing receipts over \$5,000, whether gifts in kind or cash, as to the existence of any circumstances involving the gift, including whether there is any advantage, whether the donated property was acquired through a tax shelter, whether the donated property was acquired by the donor or any non arm’s length party within the last 3 years or 10 years and their cost of acquisition, and whether it would be reasonable to conclude that one of the main reasons for acquiring the property was to make a gift.
- New definitions of charitable organizations and public foundations will apply so that the current contribution test (not more than 50% of the capital contributed to a charitable organization or public foundation can be from one donor) will be replaced by a new control test, permitting a charity to receive contributions of more than 50% of its capital from one person or group of persons, provided that the donor does not control the charity or represent more than 50% of the directors and trustees of the charity retroactively to January 1, 2000.
- Gifts made by a charity to a non qualified donee would become cause for revocation of the charity’s status.

- Municipal or public bodies performing a function of government in Canada will also qualify to be a qualified donee.

D. CONCLUSION

These new rules bring sweeping changes that affect charities in many ways. It is important that charities and their advisors become familiar with these changes in order to ensure compliance. Further, there are many areas where the July 2005 proposal is not clear. It is hoped that any grey areas will be clarified either by remedial amendments to the Act or by CRA providing the charitable sector with administrative guidelines on how these statutory provisions will be interpreted by CRA and how charities may be required to comply with them.

¹ The effects of these changes have been summarized in the following *Charity Law Bulletins* and paper, all of which are available on our website at www.charitylaw.ca, and readers are encouraged to refer to them for more detail:

- Amendments to the Act release on September 16, 2004 are explained in *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.
- Amendments to the Act release on December 6, 2004 are explained in *Charity Law Bulletin* No. 61, dated January 12, 2005, available on our website at www.charitylaw.ca.
- Bill C-33 – See paper by M. Elena Hoffstein and Theresa L.M. Man, *New Disbursement Quota Rules Under Bill C-33*, presented at the Canadian Bar Association /Ontario Bar Association 3rd National Symposium on Charity Law on May 6, 2005.

² The effects of these changes have been summarized in the following *Charity Law Bulletins* and paper, all of which are available on our website at www.charitylaw.ca, and readers are encouraged to refer to them for more detail:

- December 2002 Amendments – See *Charity Law Bulletin* No. 21, “Commentary on Draft Technical Amendments to the *Income Tax Act* Released on December 20, 2002 that Affect Charities,” dated April 30, 2003.
- December 2003 Amendments – See *Charity Law Bulletin* No. 30, “Tax Shelter Donation Schemes,” dated December 16, 2003 and *Charity Law Bulletin* No. 38, “December 5, 2003 *Income Tax Act* Amendments Affecting Charities,” dated February 19, 2004.
- February 2004 Amendments – See *Charity Law Bulletin* No. 40, “February 27, 2004 Revised Draft Amendments to the *Income Tax Act* Affecting Charities,” dated March 29, 2004.
- July 2005 Amendments – See *Charity Law Bulletin* Nos. 76 and 77, “July 18, 2005 Draft Amendments to the *Income Tax Act* Affecting Charities: Part I – Definition of Gift & Split-Receipting and Part II – Other Changes,” dated September 8, 2005.