

CRA REGISTERED CHARITIES NEWSLETTER HIGHLIGHTS FROM 2006

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A. INTRODUCTION

Canada Revenue Agency (“CRA”) released two *Registered Charities Newsletters* (“Newsletters”) in 2006. This *Charity Law Bulletin* highlights the content of the two Newsletters. The Newsletters address a broad array of topics related to registered charities, including guidelines for maintaining adequate books and records and related case law. There is also various questions and answers regarding receipts, enduring property and planned giving, a link to CRA’s policy for registered charities meeting the “public benefit test”, and guidance with respect to restrictions on private foundations. The following sections provide a brief summary of these and other issues discussed in the Newsletters.

B. WINTER 2006: REGISTERED CHARITIES NEWSLETTER NO. 26

Upon the release of CRA’s Winter 2006 Newsletter, “just over a year [had passed] since a tsunami devastated large parts of coastal areas that border the Indian Ocean.”¹ In response to that disaster, many Canadians made generous donations to charities which were offering assistance to the victims of the tsunami. Maintaining adequate books and records is an essential requirement for all charities, but when urgent charitable work outside of Canada became more prevalent, many specific questions concerning books and

¹ CRA, *Registered Charities Newsletter* No. 26, online: <http://www.cra-arc.gc.ca/E/pub/tg/charitiesnews-26/README.html>.

records were raised with CRA. Consequently, CRA dedicated this Newsletter to explaining how charities are required to maintain their books and records.

1. CRA's Summary on Books and Records

CRA's summary on books and records provides as follows:

A registered charity must keep adequate books and records at a Canadian address it has on file with us, so that we can verify official donation receipts issued, as well as its revenue and expenditures. It must also include information that will enable the Minister to determine if there are any grounds for revocation. A charity must also keep source documents that support the information in the records and books of account.

2. Statutory Provisions and Publications

CRA highlights the following statutory provisions and helpful links on their website which are relevant to the books and records of charities:

- ♦ Subsection 230(2) of the *Income Tax Act* (the "Act")² contains the statutory requirement for the proper maintenance of books and records.
- ♦ Subsections 230(4) to (8) of the Act and Regulation 5800 set out the requirements concerning the retention and destruction of books and records, which are explained in CRA's Information Circular IC 78-10R4 entitled *Books and Records Retention/Destruction*.³
- ♦ Subsections 230(4) to (7) of the Act and Regulation 5800 provide for the length of time that books and records must be retained, which varies by the type of record. For example, the retention period for church offering envelopes is two years following the end of the fiscal period for which they were made available.⁴ Under subsection 230(8), the Minister may give written permission for earlier disposal. The Newsletter contains a table providing a helpful overview of the general requirements in this regard for registered charities.
- ♦ Electronic records and paper records are subject to the same requirements as paper records. Pursuant to subsection 230(4.1) of the Act, electronic records must be retained in an

² R.S.C. 1985, c. 1 (5th Supp.), as amended.

³ CRA, Information Circular, IC 78-10, *Books and Records Retention/Destruction*, June 2005, online: <http://www.cra-arc.gc.ca/E/pub/tp/ic78-10r4/README.html>.

⁴ CRA, Information Letter CIL – 2001 – 021, online: <http://www.cra-arc.gc.ca/tax/charities/policy/cil/2001/cil-021-e.html>.

electronically readable format for the same length of time as required for paper records. For more information, see CRA's publication IC05-1 entitled *Electronic Record-Keeping*.⁵

- ♦ Charities are required to keep adequate books and records in either English or French at a Canadian address so that CRA can verify official receipts issued, verify income received and expenses made, as well as determine whether their activities are charitable. Although not required under the Act, CRA suggested that it would be prudent for charities to keep more than one copy of its books and records to safeguard them in the event of fire or other disaster that may destroy their books and records. For information on books and records for charities that operate outside Canada, see *Registered Charities Newsletter* No. 20 (Fall 2004).⁶
- ♦ A charity that fails to comply with the requirement concerning keeping adequate books and records may be subject to having its tax-receipting privileges suspended or its charitable status revoked.
- ♦ Pursuant to subsection 286(1) of the *Excise Tax Act*,⁷ a charity that carries on a business or engages in a commercial activity in Canada is required to file a GST/HST return. In addition, a charity that makes an application for a rebate or refund is required to maintain adequate books and records in either English or French in Canada.⁸

3. Comments on Cases Relating to Books and Records

CRA reviews three Federal Court of Appeal decisions, *Canadian Committee for the Tel Aviv Foundation v. Canada*,⁹ *College Rabbinique de Montreal Oir Hachaim D'Tash v. Canada (Minister of the Customs and Revenue Agency)*,¹⁰ and *The Lord's Evangelical Church of Deliverance and Prayer of Toronto v. Canada*,¹¹ all of which addressed the requirement of adequate books and records. Based on these decisions, CRA concludes the following:

Based on these court cases, we know that:

- ♦ the responsibility to prove the facts in a revocation case lies with the registered charity;
- ♦ charities must make books and records available to the CRA at the time of audit;

⁵ CRA, Information Circular IC05-1, *Electronic Record-Keeping*, June 2005, online: <http://www.cra-arc.gc.ca/E/pub/tp/ic05-1/README.html>.

⁶ CRA, *Registered Charities Newsletter* No. 20 (Fall 2004), online: <http://www.cra-arc.gc.ca/E/pub/tg/charitiesnews-20/README.html>.

⁷ R.S. 1985, c. E-15.

⁸ CRA, GST/HST Series, *15.1 General Requirements for Books and Records*, online: <http://www.cra-arc.gc.ca/E/pub/gm/15-1/15-1-e.html>.

⁹ 2002 FCA 72.

¹⁰ 2004 FCA 101.

¹¹ 2004 FCA 397.

- ♦ failure to maintain proper books and records in accordance with subsection 230(2) of the *Income Tax Act* is itself sufficient reason to revoke an organization's charitable status; and
- ♦ even small organizations that depend on volunteers are responsible for ensuring that their books and records are maintained in a meaningful way.

In general, when the CRA becomes aware that a charity's books and records are inadequate, it will make the charity aware of the problems and provide the charity with the opportunity to address the CRA's concerns. However, a single significant failure or repeat failures can lead to a one-year suspension of receipting privileges revocation."¹²

C. FALL 2006: REGISTERED CHARITIES NEWSLETTER NO. 27

This Newsletter focuses on information with respect to the changes to legislation affecting charities, particularly changes to the disbursement quota and the new interim sanctions. CRA indicates that the new appeals process will be the subject of a future newsletter.

1. Guidelines for Applying the New Sanctions

Revocation of a charity's registered charitable status was long thought by many to be a sanction too severe. As a result of a recommendation by the Joint Regulatory Table,¹³ there are now less severe penalties in place for charities which are found, as a result of an audit by CRA, to not be in compliance with rules under the Act. "As a general rule, [CRA] intend[s] to use educational methods to obtain compliance, and then move progressively through compliance agreements, sanctions, and ultimately to revocation, if necessary."¹⁴ The Charities Directorate of CRA is in the process of developing *Guidelines for Applying the New Sanctions*, which will be available at www.cra.gc.ca/charities.

2. Filing of T3010

CRA reminded charities that their T3010 must be filed with CRA at the correct address at Charities Directorate, Canada Revenue Agency, Ottawa, Ontario K1A 0L5. CRA also explained the difference

¹² *Supra* note 1.

¹³ This group was comprised of representatives of the government and voluntary sector. Their work culminated in *Regulatory Reform Final Report: Strengthening Canada's Charitable Sector*, which can be found on the Voluntary Sector Initiative's website at: http://www.vsi-isbc.ca/eng/regulations/jrt_finalreport/index.cfm.

¹⁴ CRA, *Registered Charities Newsletter No. 27*, online: <http://www.cra-arc.gc.ca/E/pub/tg/charitiesnews-27/README.html>. (At the time of writing, this hyperlink on the CRA website was broken.)

between “mailing address,” “physical address” and “address where books and records are located” on the T3010. The latter two addresses are not displayed on CRA’s website and are, therefore, not available to the public.

3. Questions and Answers

CRA included a series of “questions and answers” on a variety of issues pertaining to rules under the Act which charities must follow.

a) Receipts – Who is the donor?

Pursuant to Regulations 3501(1)(g) and 3501(1.1)(g), an official donation receipt must bear the name and address of the donor. CRA provides a reference to their policy commentary, *Name on Official Donation Receipt*, concerning the circumstances in which someone may be considered a donor.¹⁵ The Act only allows a registered charity to issue official donation receipts for income tax purposes in exchange for a gift, for which there must be a transfer of property. CRA indicates that contributions of services (*i.e.*, time, skills or effort) are not considered property and as such, an official donation receipt cannot be issued for those services. However, it is permissible for the charity to pay the individual who contributes the service and for that person to then donate an amount to the charity in exchange for an official donation receipt.

b) Enduring Property and Estate Gifts

New rules for the calculation of disbursement quota were enacted on May 13, 2005.¹⁶ Among others, the new rules provide charities with the ability to encroach on realized capital gains of enduring property. 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.

Since the enactment of the new rules, there have been a lot of questions regarding when charities are required to include enduring property in the calculation of their disbursement quota. In general,

¹⁵ CRA, Policy Commentary CPC-010, *Name on Official Donation Receipt* (February 21, 1994), online: <http://www.cra-arc.gc.ca/tax/charities/policy/cpc/cpc-010-e.html>.

¹⁶ 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.

gifts of enduring property are generally excluded from a charity's disbursement quota in the year they are received. However, the charity must consider these gifts when calculating the average value of property for its 3.5% disbursement quota requirement. When the charity spends or transfers some or all of the enduring property, 80% of the amount spent or 100% of the amount transferred must be included when calculating the disbursement quota requirement. In addition, transfers from registered charities to charitable organizations were previously exempt from the recipient charitable organization's disbursement quota. Under the new disbursement quota rules, there are three types of property transfers between charities: specified gifts, enduring property, and other gifts, which are each treated differently. This Newsletter provides general guidelines on how these rules would apply in different situations.

In addition, CRA explained that an enduring property would include a bequest received from the will of a deceased person. When a gift is made as a result of a person's death and the gift satisfies the requirements to be a gift made by the will of the testator pursuant to subsection 118.1(5) of the Act, this would allow donation tax credits be claimed by the deceased, rather than by the estate, in the year of death and the year prior to death up to 100% of the testator's income. In situations where the requirements under subsection 118.1(5) are not satisfied, the estate or the testamentary trust, instead of the deceased, may be entitled to a charitable donation credit pursuant to subsection 118.1(3) of the Act up to 75% of the income of the estate or trust. This Newsletter provides guidelines on the circumstances in which a gift made by an individual's will would be deemed to have been made under section 118.1(5) of the Act and thereby entitles the deceased, as opposed to the estate, to claim a charitable donation credit.

c) Planned Giving

On the topic of planned giving, CRA discusses charitable gift annuities,¹⁷ life insurance policies and charitable remainder trusts.¹⁸

- ♦ "Charitable gift annuity" is "an arrangement under which a donor contributes funds to a charitable organization in exchange for guaranteed payments for life at a specified rate depending on life expectancy or for a fixed term." This Newsletter explains how annuity

¹⁷ For more information concerning charitable gift annuities, see CRA's *Income Tax Technical News* No. 26, online: <http://www.cra-arc.gc.ca/E/pub/tp/itnews-26/README.html>

¹⁸ For more information on these types of gifts, see CRA's *Income Tax Interpretation Bulletin* IT-226R, *Gift to a Charity of a Residual Interest in Real Property on an Equitable Interest in a Trust*, online: <http://www.cra-arc.gc.ca/E/pub/tp/it226r/it226r-e.html>.

payments received by the annuitants after they have exceeded their life expectancy would be taxed, and how the capital element of a life annuity would be determined.

- ♦ This Newsletter explains that where a life insurance policy has been absolutely assigned to a charity and makes the charity the registered beneficial owner of the policy, the charity may issue a donation receipt for the value of the policy, as well as the accumulated dividend and interest. However, where the policy has no value, then there is no gift and a receipt cannot be issued.
- ♦ A “charitable remainder trust” involves the transfer of property to a trust “whereby the donor or beneficiary retains a life or income interest in the trust but an irrevocable gift of the residual interest is made to a registered charity.” A registered charity can issue an official donation receipt for the fair market value of the residual interest at the time that the residual interest vests in the charity.

4. Policies: Public Benefit Test

CRA provides a link to a policy with respect to how organizations seeking registered charitable status can meet the public benefit test, namely *Guidelines for Registering a Charity: Meeting the Public Benefit Test (CPS-024)*.¹⁹ (The Newsletter does not include any specific commentary on the policy.)

5. Experts Corner

a) Debts incurred by charitable foundations

With respect to CRA’s Technical Interpretation dated October 21, 2005,²⁰ CRA reversed its strict position with respect to public and private foundations incurring debts for the purpose of acquiring investment, enabling both to now do so. Previously, CRA had always been of the view that the phrase “debts incurred in connection with the purchase and sale of investments” in paragraphs 149.1(3)(d) and 149.1(4)(d) of the Act would only permit a miscellaneous type of debt, such as brokerage fees or other incidental amounts that could relate either to the purchase or the sale. However, CRA reminded charities that in doing so, other issues may arise, such as personal benefits involved in debt arrangements and disbursement quota issues of the borrowed capital.

¹⁹ CRA, *Guidelines for Registering a Charity: Meeting the Public Benefit Test (CPS-024)*, March 10, 2006, online: <http://www.cra-arc.gc.ca/tax/charities/policy/cps/cps-024-e.html>.

²⁰ CRA, Technical Interpretation 2005-015475117, *Debts Incurred By Charitable Foundations*, October 21, 2005.

b) Restrictions on private foundations

Also included in the Newsletter is an explanation of some of the restrictions applicable to private foundations, such as those related to prohibition of private foundation to carry on any business activities,²¹ prohibition on private foundation to incur certain types of debts, and strict rules that apply when a private foundation received non-qualified investments.

c) Gift of residue from an estate

As indicated above, when a gift is made as a result of a person's death and the gift satisfies the requirements to be a gift made by the will of the testator pursuant to subsection 118.1(5) of the Act, this would allow donation tax credits be claimed by the deceased. In some cases, rather than specifying that particular property (gifts in kind) is to be donated to a charity, people specify that the "residue" will be left to the charity. CRA indicated that generally where the executors have no entitlement to encroach on the capital of the estate, the property required to be donated to the charity in the circumstances described above would qualify as a gift by the individual's will for purposes of subsection 118.1(5).

6. Court News

CRA provides case comments for two recent Federal Court of Appeal ("FCA") decisions and one Tax Court of Canada ("TCC") decision from 2004.

a) Promotion of amateur athletics

With respect to the FCA decision in *A.Y.S.A. Amateur Youth Soccer Association v. Canada Revenue Agency*,²² CRA comments as follows:

On April 5, 2006, the Federal Court of Appeal ruled that the CRA was correct in refusing to register the A.Y.S.A. Amateur Youth Soccer Association as a charity under the [Act]. The Court held that the scheme of the Act precluded the registration of amateur sports associations as charities, and only permitted the separate registration of Canadian amateur athletic associations where these operated on a nation-wide basis. The Association has filed for and been granted leave to appeal with the Supreme Court of Canada.

²¹ CRA, Policy Statement, *What is a Related Business?* (CPC-019), March 31, 2003, online: <http://www.cra-arc.gc.ca/tax/charities/policy/cps/cps-019-e.html>

²² 2006 F.C.A. 136.

b) Conducting activities in foreign countries

With regard to the FCA decision in *Bayit Lepletot v. Minister of National Revenue*,²³ “at issue was whether the appellant was carrying on its own charitable activities” in connection with three institutions for orphans in Israel which had been operated by an Israeli organization since 1947. CRA’s case comment provides as follows:

Through an audit, the CRA took the position that the organization was not carrying on its own charitable activities. While the organization did enter into an agency agreement with a Rabbi associated with the institutions, there was no evidence to show that the Rabbi exercised any control over the charitable activities in his capacity as the appellant’s agent. The Court found that proof of the agency relationship was not sufficient in itself to demonstrate that the appellant had control over the activities being carried out by its agent. The appellant must be able to demonstrate that the charitable activities being carried are its own charitable activities.

c) Donation where there is no provision in a will

In *MacDonald Estate v. The Queen*,²⁴ at issue was whether the testatrix made a donation to a registered charity. Under the terms of her will, the residue from the testatrix’s estate was to be divided equally among four beneficiaries, including her brother, Father Joseph MacDonald, if he survived her. Although he did predecease his sister, the executrix of the estate argued that gift of residue made to the registered charity Poverello, an orphanage for which Father MacDonald had worked, should qualify as a gift made under the will of the deceased because Father MacDonald and Poverello “were one and the same.” The TCC agreed with the Minister of National Revenue that the taxpayer’s appeal should be dismissed because there was no specific provision in the will for a donation to the charity. Even though Father MacDonald would likely have given the funds to the orphanage, “no obligation to do so was imposed upon him by the words which the testatrix used in her will, and thus the bequest cannot be said to be to the charity.” As CRA indicates earlier in the Newsletter, it is permissible for a gift of residue from an estate to be made to a charity, but the will’s terms must clearly state as such.

²³ 2006 F.C.A. 128.

²⁴ 2004 DTC 2694.

D. CONCLUSION

Charities will find that these two CRA Newsletters from 2006 provide helpful direction on a range of important issues, especially with respect to donation receipts, enduring property, planned giving. As well as maintaining adequate books and records, all charities should give careful consideration to CRA's various guidelines found in their newsletters available at: <http://www.cra-arc.gc.ca/tax/charities/newsletters-e.html>. Other summaries of CRA newsletters can be found at www.charitylaw.ca.