
**ONTARIO LAND TRUST ALLIANCE
OLTA GATHERING 2010**

EXPANDING HORIZONS

Peterborough – October 29, 2010

Recent Tax Changes

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TOPICS

- 2010 Budget - New DQ rules
- T3010B
- Fundraising Considerations
- American Friends of Canadian Land Trusts

A. 2010 BUDGET - NEW DQ RULES

1. Background

- Disbursement quota is prescribed amount that registered charities must disburse each year in order to maintain charitable registration
- Purposes of DQ
 - Curtail fundraising costs
 - Limit administration costs
 - Limit capital accumulation
 - Ensure significant resources devoted to charitable activities
- DQ introduced in 1976
- Rules reformed by 2004 Budget - more complex

2. Current 80% DQ and 3.5% DQ

- A charity must spend each year on charitable activities (including gifts to other charities) what is at least equal to 80% DQ + 3.5% DQ
- Failure to meet DQ is grounds for revocation
- 80% DQ (“charitable expenditure rule”)
 - The sum of
 - 80% of gifts received in the immediately preceding year (except gifts of enduring property and gifts received from other charities)

- 3.5% DQ (“capital accumulation rule”)
 - Must expend 3.5% of assets not used directly in charitable activities or administration (“investment assets”)
 - Based on the average value of assets in 24 months immediately preceding the taxation year
 - 3.5% DQ does not apply if property is \$25,000 or less

3. Reform Efforts

- CRA Fundraising Guidance released June 11, 2009
 - Regulates fundraising costs and fundraising practices
 - Fundraising ratio: fundraising costs to fundraising revenue in a fiscal year
 - 35% or less - unlikely to generate questions or concerns
 - 35 to 70% - CRA will examine average ratio over recent years to determine if there is trend of high fundraising costs
 - Over 70% - will raise concerns with CRA and will likely result in revocation

- CBA Concept paper to Finance
 - July 2009
 - Four regulatory objectives pursued by current DQ regime
 - (1) Current gifts disbursement
 - (2) Anti-accumulation
 - (3) Administrative efficiency – via increased transparency
 - (4) Fundraising efficiency – via CRA Fundraising Guidance

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- Objectives (1) + (2) = prevention of undue accumulation of donations, income and capital
- Made recommendations for reform to simplify DQ
- Supported by Imagine Canada, CAGP and other organizations in the charitable sector

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4. 2010 Budget DQ Rules

- Changes proposed
 - Repeal of 80% DQ
 - Repeal of 80% DQ related concepts
 - Enduring property (including ten-year gifts)
 - Capital gains pool
 - Specified gifts
 - Increased threshold for 3.5% DQ to \$100,000 for charitable organizations (remained at \$25,000 for foundations)

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- Expanded anti-avoidance provisions

- Where it can reasonably be considered that purpose of a transaction was to delay unduly or avoid application of DQ
- To ensure amounts transferred between non-arm's length charities will be used to satisfy DQ of only one charity

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- A gift received from non-arm's length charity will need to be expended by following year (in addition to its 3.5% DQ)
 - Unless the transferor charity elects that gift will not count toward satisfying its own 3.5% DQ ("designated gift")
 - Otherwise grounds for revocation
 - 110% penalty of fmv of the property exceeds the amount expended

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- CRA will be given discretion to exclude accumulated property from 3.5% DQ

- CRA has discretion to allow charities to accumulate property for a particular purpose, such as a building project
- Currently, property accumulated (and income earned) with CRA approval is deemed to have been spent on charitable activities

- Effective for fiscal years that end on or after March 4, 2010
- Finance will monitor effectiveness of CRA's Fundraising Guidance and take action if needed to ensure its stated objectives are achieved

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5. CRA's Steps

- CRA update April 1, 2010
- CRA indicated it will make administrative changes, has released Q&A: <http://www.cra-arc.gc.ca/gncy/bdgt/2010/chrt-eng.html>
- CRA has produced new instructions on how to calculate DQ for fiscal years that end on or after March 4, 2010: http://www.cra-arc.gc.ca/chrts-gvng/chrts/bdgt2010/t3010_nsr-eng.html
- Form T3010B will be revised to reflect new DQ calculation (charities must continue to use existing form with until a new form is released)

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6. Implications Of New DQ Rules

- Welcomed change
- Simplicity of DQ calculation
- Ease administrative burden for charities (especially small and rural)
- No need to spend scarce resources allocating expenses between charitable vs administrative expenses for 80% DQ
- Increase of \$100,000 threshold for charitable organizations allows them greater ability to maintain reserves to deal with contingencies

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- What to do with existing endowment funds, long-term gifts and ten-year gifts?
 - Questions
 - Can capital be encroached?
 - Still need to track 10-year period?
 - Still need to track hold period?
 - Need to review all existing gift agreements and trust provisions

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- Whether can encroach will depend on language of agreement
 - Does agreement permit encroachment of capital or expenditure of income only?
 - Does language specifically allow encroachment up to capital gains pool? With capital gains pool repealed, what to do?
 - May need cypres court order to vary terms
 - If terms impractical or impossible
 - E.g. Ontario – section 13 of *Charities Accounting Act*

- New Gifts
 - No need to struggle with structuring long-term gifts or endowment funds to comply with complex ITA language related to enduring property
 - Flexibility in structuring new gifts – can focus on balancing:
 - Donor desires for long-term financial stability
 - Need for flexibility to meet changing economic conditions

- Encroachment
 - Ability to encroach capital?
 - Discuss with donor under what circumstances
- Income and capital
 - May be remove reference to income and capital
 - Use total return investment and payout strategy instead
- Length of hold period
 - 10 year is no longer a “magic number”
 - Discuss with donor appropriate length
 - May be “long term” rather than perpetuity

B. THE NEW T3010B

1. Background

- The T3010B is the new annual information return for registered charities for fiscal periods ending on or after January 1, 2009
- The new form is a response from Canada Revenue Agency ("CRA") to demand from smaller charities to reduce their filing burdens
- The T3010B also provides accountability to the public and to potential donors, since most of the return is available on the CRA website once it is filed

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- However, for larger charities, there are now increased reporting requirements
- In this regard, the T3010B is also an enforcement tool for CRA, since it allows CRA to see if a charity has been compliant with the requirements of the *Income Tax Act* ("ITA")
- For example, the T3010B will allow the CRA to :
 - Ensure that the charity has met its disbursement quota requirements;
 - Verify if the charity has made any gifts to non-qualified donees; and
 - Determine if the charity maintains an acceptable fundraising ratio

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2. Overview of the T3010B

- The T3010B consists of two parts
 1. Sections A-F
 - A. Identification (public information)
 - B. Directors/trustees and like officials (Form T1235(09) (partially public information)
 - C. Programs and General Information (public information)
 - D. Financial Information (public information)
 - E. Certification (publicly available, but not online)
 - F. Confidential Data

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2. Schedules 1-6

- 1. Foundations (public information)
- 2. Activities Outside Canada (public information)
- 3. Compensation (public information)
- 4. Confidential Data (private information)
- 5. Non-Cash Gifts (public information)
- 6. Detailed Financial Information (public information, including financial statements)

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- Public portions of the T3010B also include the following forms;
 - TF725 *Registered Charity Basic Information Sheet*
 - T1235(09)/RC232-WS or RC232 regarding directors/trustees and like officials;
 - T1236(09) regarding qualified donees; and
 - T2081 regarding excess corporate holdings for private foundations
- Sections A-F, which is the *primary* portion of the T3010B, contains questions that act as triggers to further reporting requirements set out in Schedules 1 to 6

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3. Tips For Filling Out The T3010B

- In general, CRA recommends
 - Except for yes/no questions, if a question does not apply, leave it blank
 - All requested information must be entered on the return itself (except for the Financial Statement, which is to be attached separately)
 - Report all dollar amounts in Canadian funds, and round all amounts to the nearest single dollar
- What follows is a selective list of tips for completing the T3010B

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- Question C10 asks if the charity has received any donations valued at \$10,000 or more from a donor not resident in Canada, and who was not:

- o A Canadian citizen;
- o Employed in Canada;
- o Carrying on a business in Canada;
- o A person having disposed of taxable Canadian property

▪ If answering "yes" to C10, the charity will have to fill out Schedule 4 – Confidential Data as well, which applies to individual governments and organizations

▪ In order to complete Schedule 4, charities must ensure that they have all the requisite data from non-resident donors

▪ This can be difficult, and will require consent of the donor, who may not want this information to be shared with CSIS, RCMP or foreign governments and agencies as permitted under Bill C-25

- If the charity received non-cash gifts, it must answer "yes" to question C11, which will require the completion of Schedule 5

▪ Note that the value for these needs to include the total dollar value of tax receipted non-cash gifts

▪ Independent appraiser should be provided with all necessary information, including that the appraisal is being done for a charity, to determine fair market value for gifts like art or jewelry

- Be very cautious with question C14 as the question is a trap, in that it asks if the charity has issued receipts on behalf of another organization

- Under the ITA, a charity is not permitted to allow another organization to use their registration number
- If a charity must answer “yes” to question C14, they should seek legal advice to consider possibly proceeding with a voluntary disclosure to CRA to avoid an audit and possible revocation

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- Section D – Financial Information
 - In accordance with CRA's desire to lessen the reporting requirements for smaller charities, a smaller charity can complete this section IF:
 - The charity's revenue does not exceed \$100,000;
 - The amount of all assets not used in its charitable programs does not exceed \$25,000; and
 - The charity has not obtained permission to accumulate funds during the fiscal period
 - Disregard option d) – no longer applicable

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- If the charity does not meet all of these criteria, then it must fill out the more extensive Schedule 6 – Detailed Financial Information
- Schedule 6 - Detailed Financial Statements: Selected Tips
 - Lines that relate to the calculation of the 80% DQ – many are no longer applicable or are modified:
 - Line 5640 – n/a
 - Line 4510 should now read: "Total amount received from other registered charities."
 - Line 4520 - n/a
 - Line 4525 – n/a

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- Line 5050 should now read: "Total amount of gifts made to all qualified donees."
- Line 5060 – n/a
- Line 5070 – n/a
- Line 5100 should now read: "Total expenditures (add the amount from line 4950 and the amount from line 5050)."
- Line 5520 - n/a
- In the section "Enduring property and the capital gains pool," lines 5710, 5720, 5730, and 5740 are no longer applicable

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- 3.5% DQ is based on an average fair market value of the those assets averaged over the previous 24 month period
- This is calculated on lines 5900 for the current fiscal year and 5910 for the next fiscal year
- Therefore, it is important that a charity have adequate records of property value for the 2 years preceding the beginning of the fiscal year

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- In addition to completing either Section D – Financial Information or Schedule 6, charities must also provide financial statements as part of their return in order to comply with their filing requirements
 - Should include at a minimum a balance sheet and income statement
 - This must be done even if the charity was not active during the fiscal period
 - Although not required, CRA recommends that charities with incomes over \$250,000 have the financial statements professionally audited, or signed by the treasurer for the charity

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- Section E – Certification - Carefully consider the individual who will sign
 - That person must be a director/trustee or like official who has authority to sign on behalf of the charity
 - This person will be certifying the return “to the best of [his or her] knowledge”
 - Therefore, this individual must ensure that the information provided on the return is complete and accurate
 - The T3010B provides a reminder in Section E that it is a serious offence under the ITA to provide false or deceptive information

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4. What To Do After Filing The T3010B

- Check again the T3010B *Registered Charity Information Return* checklist to ensure that all the requisite forms are included in the return
- Have the board or like officials review the T3010B before submitting it, then check it for accuracy and completeness
 - The T3010B information will be used by CRA auditors in the future
- Ensure that no amendments to governing documents are included with the return
 - CRA now requests these to be sent separately

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- Check the T1242 *Registered Charity Information Return Summary*
 - CRA will mail out a copy after the charity has filed the T3010B
 - This will contain CRA's capital gains pool calculation, capital gains reduction calculation, DQ calculations, and certain reported and recalculated financial totals, based on what is provided on the T3010B
 - This information will be posted on CRA website to be viewed by the public
- Subsequent corrections to T3010B can be made by submitting the T1240(05) form

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5. What are the Consequences of Failing to File the T3010B

- The T3010B must be filed within 6 months after the end of the charity's fiscal period (fiscal period can only be changed with approval of CRA)
- Failure to do so will likely result in revocation of charitable status, meaning:
 - The charity is no longer exempt from tax;
 - The charity cannot issue any official donation receipts; and
 - The charity may be subject to the revocation tax (equivalent to the full value of its remaining assets)

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- CRA generally gives charities a chance to rectify this non-compliance
 - 5 months after a charity's fiscal year end, CRA will send a reminder e-mail to the charity
 - 7 months after the fiscal year end, CRA will send a T2051A *Notice of Intention to Revoke Charitable Status*
 - The charity must file its T3010B within 30 days from the mailing of the notice
 - Failure to do so will result in revocation of charitable status
 - If the charity believes it has met its filing requirements, it will have 90 days to file an objection with CRA's Appeals Branch

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- 8 months after the fiscal year end, CRA will attempt to personally contact representatives of the charity to remind them to file their T3010B
- 10 months after the fiscal year end, CRA will send a T2051B *Notice of Revocation of Charity's Registration*
 - Charity must submit T2046 *Tax Return Where Registration of a Charity is Revoked* within 1 year of the date indicated on the notice

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- In order to reregister, the charity will have to:
 - Pay \$500 penalty
 - Complete T2050 re-registration application
 - Submit all missing annual returns
- CRA may not reregister the charity, as CRA will treat a charity with revoked status the same as though they are applying for the first time
 - The charity must meet all *current* requirements, which may be different than when the charity first registered

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C. FUNDRAISING CONSIDERATIONS

- From the media's perspective this is a number one compliance issue
- While the CRA accepts that charities can have fundraising costs, its expectation is that these expenses be reasonable and proportionate to the charitable activity being conducted

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- A charity which spends excessive amounts on fundraising to the detriment of its charitable programs is not considered to be devoting all of its resources to charitable activities
- Additionally, spending excessive amounts on fundraising results in disbursement quota shortfalls and often deliberate, incorrect categorization of expenses (i.e., including fundraising expenses as a charitable program expenditure)

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- CPS-028, *Fundraising by Registered Charities* available at <http://www.cra-arc.gc.ca/>
 - The Guidance focuses on the calculation of fundraising ratio, i.e., the ratio of fundraising costs compared to fundraising revenue on an annual basis
 - The ratio will place a charity in 1 of 3 categories

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- Under 35%: Unlikely to generate questions or concerns by CRA
- 35% to 70%: CRA will examine the average ratio over recent years to determine if there is a trend of high fundraising costs requiring a more detailed assessment of expenditures
- Above 70%: This will raise concerns with CRA and the charity must be able to provide an explanation and rationale for this level of expenditure, otherwise it will not be acceptable

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- Seven best practice indicators that will decrease the risk of CRA finding unacceptable fundraising
 1. Prudent planning processes
 2. Appropriate procurement processes
 3. Good staffing processes
 4. Ongoing management and supervision of fundraising practice
 5. Adequate evaluation processes

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- 6. Use made of volunteer time and volunteered services or resources
- 7. Disclosure of fundraising costs, revenues and practice

- See also Office of the Public Guardian and Trustee, *Charitable Fundraising: Tips for Directors and Trustees*
<http://www.attorneygeneral.jus.gov.on.ca/english/family/pgt/charbullet/bulletin-8.asp>

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