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**REVOCATION AND ANNULMENT OF REGISTERED  
CHARITIES IN SEPTEMBER 16, 2004 DRAFT  
AMENDMENTS TO THE *INCOME TAX ACT***

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**A. INTRODUCTION**

This is the second in a series of four *Charity Law Bulletins* commenting on the draft amendments to the *Income Tax Act* (the “Act”) released by the Department of Finance (the “Department”) on September 16, 2004 (the “September 2004 Amendments”) that, when adopted, will implement the initiative of the Federal Government in rewriting the tax rules concerning the taxation and administration of charities as set out in the Federal Budget that was announced on March 23, 2004 (the “2004 Budget”). Details regarding the 2004 Budget are summarized in *Charity Law Bulletin* No. 41.<sup>1</sup> Amendments to the Act regarding new proposed intermediate taxes and penalties are summarised in *Charity Law Bulletin* No. 54 dated October 29, 2004<sup>2</sup>, the first *Charity Law Bulletin* in this series. This *Charity Law Bulletin* will provide a commentary on the amendments to the Act in relation to revocation and annulment of registered charities. Changes to the Act in relation to the following will be commented upon in the third and fourth *Charity Law Bulletin* in this series.

- No trading in charitable donations;

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<sup>1</sup> *Charity Law Bulletin* No. 41 dated March 30, 2004 is available on our website at [www.charitylaw.ca](http://www.charitylaw.ca).

<sup>2</sup> *Charity Law Bulletin* No. 54 dated October 29, 2004 is available on our website at [www.charitylaw.ca](http://www.charitylaw.ca).

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- 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 website of Canada Revenue Agency (“CRA”); and
- New disbursement quota rules.

As indicated in *Charity Law Bulletin* No. 54 dated October 29, 2004, it is important to note that the proposals that are set out in the 2004 Budget should be read in addition to the February 27, 2004 revised draft technical amendments, which were commented on in *Charity Law Bulletin* No. 40,<sup>3</sup> as well as in a paper by the authors entitled “Recent Changes to the *Income Tax Act* and Policies Relating to Charities and Charitable Gifts (current to March 1, 2004).”<sup>4</sup>

## **B. REFUSAL TO REGISTER**

New subsection 149.1(22) will be included in the Act to require the Minister of National Revenue (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.<sup>5</sup> Subsection 149.1(22) applies in respect of notices issued by the Minister after the later of December 31, 2004 and 30 days after Royal Assent.

## **C. ANNULMENT**

The September 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

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<sup>3</sup> *Charity Law Bulletin* No. 40 dated March 29, 2004 is available on our website at [www.charitylaw.ca](http://www.charitylaw.ca).

<sup>4</sup> The paper “Recent Changes to the *Income Tax Act* and Policies Relating to Charities and Charitable Gifts (current to March 1, 2004)” was presented to the Society of Estate and Trust Practitioners on March 4, 2004 is available on our website at [www.charitylaw.ca](http://www.charitylaw.ca).

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 later of December 31, 2004 and 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.<sup>6</sup>

#### D. REVOCATION

##### 1. 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 September 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 later of December 31, 2004 and 30 days after Royal Assent. Subsection 188(3.1) applies to taxation years that begin after March 22, 2004.

##### a) 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

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<sup>5</sup> See explanation in relation to new subsection 168(4) in *Charity Law Bulletin* No. 56 dated October 31, 2004, which is available on our website at [www.charitylaw.ca](http://www.charitylaw.ca).

<sup>6</sup> See explanation in relation to new subsection 168(4) in *Charity Law Bulletin* No. 56 dated October 31, 2004, which is available on our website at [www.charitylaw.ca](http://www.charitylaw.ca).

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.

As a result of the 2004 Budget proposal, 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).<sup>7</sup> Amended subsection 189(8)<sup>8</sup> 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.

b) 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 subsection 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);

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<sup>7</sup> See explanation in relation to new subsection 188(1.2) in Section D1c) below.

<sup>8</sup> See explanation in relation to new subsection 189(8) in Section D5) below.

- (b) the amount of an “appropriation” (under subsection 188(2))<sup>9</sup> 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.

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”<sup>10</sup> 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).<sup>11</sup> 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.
- c) Winding-up period

As indicated above, the September 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:

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<sup>9</sup> See explanation in relation to new subsection 188(2) in Section D1e) below.

<sup>10</sup> See explanation in relation to eligible donees in new subsection 188(1.3) in Section D1d) below.

<sup>11</sup> See explanation in relation to the winding-up period in new subsection 188(1.2) in Section D1c) below..

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

In this regard, page 115 of the Explanatory Notes, set out in the attached Schedule “A” to this *Charity Law Bulletin*, provide an explanation of the application and interplay of sections 188 and subsections 189(6.1), 189(6.2).

d) Eligible donee

The September 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 the full list of qualified donees 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 a registered charity is an “eligible donee” if it satisfies all of the following requirements:

- (a) more than 50% of the members of the board of directors or trustees of the registered charity deal at arm’s length with each member of the board of directors or trustees of the charity;
- (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); and
- (e) it is not subject to a certificate under the *Charities Registration (Security Information) Act*.

However, the wording of this definition “assumes” that an eligible donee must be a registered charity, without this requirement. It would appear appropriate for the Department to make it an explicit requirement that an eligible donee must be a registered charity that satisfies the above-noted five criteria. 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.

e) 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.

f) 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 in *Charity Law Bulletin* No. 54 dated October 29, 2004, new subsection 188.1(11) introduced by the September 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.

2. 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 later of December 31, 2004 and 30 days after Royal Assent.

3. Reduction of revocation tax and penalties

The September 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 later of December 31, 2004 and 30 days after Royal Assent.

4. 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 at the later of December 31, 2004 and 30 days after Royal Assent.

5. 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 later of December 31, 2004 and 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.

6. 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 later of December 31, 2004 and 30 days after Royal Assent.

## E. CONCLUSION

The above is a summary of the changes to the Act brought about by the September 2004 Amendments implementing the 2004 Budget in relation to the process of revocation of registered charities and the calculation of the revocation tax upon revocation. As well, these new changes also clarify the authority of the Minister to annul the charitable registration of organizations that were registered in error or if the organization has ceased to be a charity “solely as a result of a change in law.” These are also welcome changes to the Act, especially in the case of the ability of the Minister to annul registered charities where it is appropriate to do so without invoking revocation tax.



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**Schedule “A”**

[Excerpt from page 115 of the Explanatory Notes to the September 2004 Amendments]

Generally, the results are as follows:

- § As the Minister would not normally assess a charity for the revocation tax before the time that the charity is required, under new subsection 189(6.1) of the Act, to file a return, if a charity has not filed a return at the time of an assessment by the Minister, the winding-up period would generally end at that time. The Minister will compute the liability for revocation tax up to the date of assessment. Under new subsection 189(6.2), the charity may continue to reduce that liability, such as by gifts to eligible donees, up to the time that is one year from the day that the certificate or notice of intention to revoke was issued. For more information, refer to the commentary for subsection 189(6.2).
- § If a charity files a return calculating the amount for which it is liable under subsection 188(1.1), the charity will include in the calculation its income and disbursements in the period up to the date of filing, but not later than one year from the day that the certificate or notice of intention to revoke was issued. This period will apply notwithstanding that the Minister may have previously assessed the charity. The Minister would normally be expected to assess the liability based on the information reported by the charity, unless the Minister disputed the calculation or other information relevant to the assessment became available to the Minister.
- § If, at any time after an assessment of the liability of the charity, the Minister reassesses that liability, the Minister will consider in the calculation the income and disbursements of the charity up to the date of that reassessment. The Minister could initiate such a reassessment, or could reassess in response to a direction from a court resulting from an appeal of the amount of tax by the charity.
- § If a charity files a notice of objection to an amount assessed under subsection 188(1.1), the time at which the Minister may begin to collect the liability is deferred by amended section 225.1, generally until any objection or appeal by the charity has been disposed of. At that time the Minister may be expected to reassess the charity to include in the calculation the income and disbursements of the charity up to the date of that reassessment.

The Minister would not normally be expected to assess a charity for the revocation tax before the time that the charity is required, under new subsection 189(6.1) of the Act, to file a return. However, there may be circumstances where the Minister becomes aware that a charity's assets are being diverted or directed for private benefit. In such a case, the Minister may consider issuing an assessment notice without waiting for the charity to file the required return. Such a charity will, for one year from the notice of intention to revoke its registration, retain the opportunity to satisfy the liability under subsection 189(6.2).