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A law newsletter for charities and NFPs by Adam Aptowitzer LL.B.

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BUDGET 2004

This is a special edition of the Aptlaw.com newsletter dedicated to reviewing the rather extensive changes to the operation of charities in the federal budget delivered Tuesday. Please keep in mind that the following cursory analysis is written for informative purposes only and for more specific inquiries please [contact me](#).

The 2004 budget delivered provided for the most extensive changes to the taxation of charities in over 20 years and was based on the four principles suggested in a recently released report by a committee of charity professionals. They were that the regulatory framework for charities in Canada should:

- (A) Facilitate public trust in the work of charities in Canada.
- (B) Uphold the integrity of the provisions in the Income Tax Act that govern charities
- (C) Ensure fair application of the law and transparency in the regulatory decision-making processes.
- (D) Be as simple, non-duplicative and cost-effective as possible.

New Federal Not-for-Profit Corporations Act

The government will finally scrap the last vestiges of the Canada Corporations Act, Part II (the "CCA") which governs the incorporation of non-share corporations on the federal level. The CCA is in many ways outdated, and this change is welcome (for-profit corporations were removed from the ambit of the CCA several years ago). Later newsletters will deal in more depth with the new legislation once more information becomes available.

New and Severe Compliance Penalties

In the past, the Canada Revenue Agency (the "CRA") (formerly known as the Canada Customs and Revenue Agency) had limited options to deal with non-compliance with the Income Tax Act. Basically, the options went from gentle (moral suasion) to draconian (revocation of a charity's registration). This budget gives the CRA more options but still allows it to revoke a charity's registration for non-compliance with the slightest rule. The general effect of this broader range of options is that penalties will be levied more often and actions (or inactions) of charities will now be far more likely to carry consequences.

The outlined penalties for some of the more common infractions include:

- A \$500 penalty for late filing of the annual information return.
- A penalty of 5% of amounts on receipts with incomplete information.

- Suspension of tax receipting privileges for failure to comply with certain verification and enforcement provisions (such as keeping proper records).
- A tax of 5% on income earned by a charity or private foundation from a business that it runs which is unrelated to its charitable objects (the tax is 100% and suspension of tax receipting privileges for a repeat violation).
- A tax of 5% on dividends received by a public foundation if it acquires control of a corporation (100% tax and suspension of tax receipting privileges on a repeat violation).
- There is also the particularly onerous penalty of 105% of any benefit conferred by the charity on any person (unrelated to their charitable objects i.e. where a charity confers a benefit on a director) and 110% for a repeat violation and suspension of tax-receipting privileges.

Finally, there will be a suspension of a registered charity's tax receipting privileges for using donated funds other than for the charity's stated charitable purposes (such as providing undue benefits to directors). A suspended charity will be prohibited from issuing official receipts and receiving funds from other charities that can issue receipts for a period of one year. Also, (and this may be the kiss of death for many charities), the charity will be required to advise potential donors of its suspension. A suspended charity's administrative and regulatory obligations will continue during this time.

Appeals Procedure

The 2004 budget also created an appeals regime similar to the standard appeals procedure available to an individual or corporation from a CRA assessment of tax. If and when the CRA denies registration to a charity or revokes the registration of an existing charity, the procedure will now allow for an appeal to an internal, yet impartial CRA appeals officer, as opposed to an automatic appeal to the Federal Court of Appeal. This is a fair change given that the CRA will probably use its new disciplinary powers more often under the new rules, and there should be an easier and less expensive method for appealing decisions to use these powers rather than an immediate appeal to the Federal Court of Appeal. However, there has been a great deal of discussion as to the actual impartiality of the appeals system within the CRA and it remains to be seen how impartial the CRA will be when its left hand is reviewing the actions of its right.

Appeals from the internal review process will go to the Tax Court of Canada and from there to the Federal Court of Appeal. However, appeals from the decisions of the CRA on registration and revocation issues will still be to the Federal Court of Appeal. This new process does not affect the anti-terrorism legislation (the Charities Registration (Security Information) Act).

Transparency and Accessibility of Information

Currently, the CRA makes available a significant amount of information about each registered charity. The budget announced measures to increase the amount of information publicly available about each registered charity. This will include:

- financial statements that are filed with annual information returns.
- letters sent by the CRA to a charity relating to the grounds for annulment of the charity's registration.

- The CRA's decisions regarding a notice of objection filed by a registered charity to disciplinary or other actions affecting the charity.
- The information that a registered charity has filed in support of an application for special status or an exemption under the Act, as well as any responses to such an application, and
- Sanctions against a registered charity, the type of sanction imposed, and the letter sent to the charity relating to the grounds for the sanction.

The CRA will also make available information regarding charities which were denied registration as a charity.

Finally, in addition to the information currently required on official tax receipts the name and website address for the CRA must appear on all official receipts issued after 2004.

Disbursement Quota Rules

The disbursement quota rules are very complex and the new budget has not simplified them to any great extent. However, there have been a number of other changes. These rules relate to the percentage of a charity's tax-receipted income in a year that it must spend in the following year.

- 1) Both foundations and charitable associations such as corporations, (under the current regime this rule only applies to foundations) are required to spend 3.5% (as opposed to the old rate of 4.5%) of their capital assets on their charitable objects. This rate is more representative of long-term rates of return.
- 2) The new rules reduce the 80% disbursement requirement that applies to the expenditure of proceeds from the sale of capital assets, to the lesser of 80% of the capital gain realized on the sale of the asset or 3.5% of the value of all property not used directly in charitable activities or administration. This removes the disincentive to registered charities from realizing capital gains in order to meet disbursement obligations to fund charitable programs and services.
- 3) Under the current rules where one charity gives official receipts for money donated, it must spend no less than 80% of that money on its charitable objects in the next year. Where one charity transfers funds to another charity, the transferred funds help the transferring charity meet this 80% quota, but this amount is not counted in the receiving charity's receipted income. So, the receiving charity does not have the same 80% requirement. This has now been changed and both charities must spend 80% of the amounts they receive on their objects.
- 4) There are a variety of other specific rules relating to the transfer of endowments between charities, gifts made by way of direct designation and

endowments received and spent in the same year.

Conclusion

Overall, the budget heralds a new age in the administration of charities. One which will require absolute vigilance to ensure that charities meet the requirements set out for them by the CRA. While some effort has been made to simplify these requirements, they remain onerous and the possible consequences for contravening them, draconian in many respects. Every charity and not-for-profit organization in Canada should have a lawyer to help guide them through these many pitfalls.

If you have any questions about the above please contact me.

[clicking here](#)

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