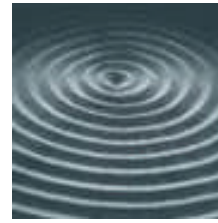
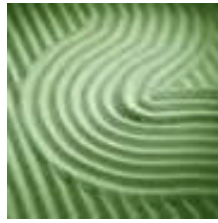


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## Highlights of the 2004 Federal Budget as it affects charities Robert B. Hayhoe April 9, 2004

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# WILLS, ESTATES, TRUSTS & CHARITIES

## Highlights of the 2004 federal budget as it affects charities

By Robert Hayhoe

The March 23, 2004 federal budget proposed significant changes to the tax regulatory regime for registered charities.

Most significant are those changes which implement the recommendations of the 2003 report of the Joint Regulatory Table of the federal government's Voluntary Sector Initiative.

The recommendations fell under three general headings: accessibility, appeals and intermediate sanctions. The budget addresses all of these recommendations.

Unfortunately, the tax measures relating to charities are covered only in the form of commentary. Details of the changes announced will have to await draft legislation.

### Intermediate sanctions

A key recommendation of the Joint Regulatory Report was that the Canada Revenue Agency be provided with the ability to apply intermediate sanctions in response to infractions which are not serious enough to justify de-registra-

tion. While the Canada Revenue Agency will continue to have the power to revoke charitable registration for violating the applicable income tax rules, the budget announced detailed new rules permitting the Canada Revenue Agency to apply various penalties and taxes.



Robert Hayhoe

It appears that many of these are designed to tax away all income earned by registered charities from a prohibited

activity. Further, if a registered charity uses donated funds for a non-charitable purpose, it may also lose the ability to issue official donation receipts or receive grants from other registered charities for a one-year period. Finally, a \$500 penalty is proposed for a charity which fails to file its T3010A information return.

In response to suggestions that it would not be appropriate for the federal government to apply a tax which prevents money from being spent on a charitable purpose, the budget proposes that where intermediate sanctions of more than \$1,000 are applied in any given taxation year against any one charity that charity will have the option of seeking permission from the Canada Revenue Agency to instead make a grant of the equivalent amount to an "eligible donee" which is defined as another registered charity which is in compliance and is not related in a defined way to the penalized charity.

Similarly, a registered charity which has its registration revoked will no longer be able to either set up a new

charity and avoid the revocation penalty tax by transferring its assets to the new related charity or transfer the assets to a qualified donee other than a registered charity (like a foreign university or a Canadian municipality).

In order to avoid penalty tax, a charity which has had its registration revoked will now be required to transfer its assets to another Canadian registered charity with a board of directors or trustees which deal at arm's length with the board of directors or trustees of the revoked charity. The revocation measures will apply from the later of Dec. 31, 2004 and 30 days from Royal assent.

### Appeals

Agency objection process (as currently exists in the general income tax context). While appeals against objection decisions dealing with intermediate sanctions will now go to the Tax Court of Canada, appeals against refusal to register and against revocation will continue to be directed to the Federal Court of Appeal. This is unfortunate and will hinder the development and clarification of the law on what entities are eligible for registration (given that the Federal Court of Appeal is expensive and only deals with these types of appeals by way of judicial review.) The appeal changes are also effective the later of Dec. 31, 2004 and 30 days from Royal assent.

### Transparency

The Joint Regulatory Table had suggested that all appeals from Canada Revenue Agency compliance decisions involving charities should be brought to the Tax Court of Canada instead of the Federal Court of Appeal. This would have been a very sensible development. Instead, the Budget introduces an internal Canada Revenue

The budget proposes to authorize the Minister of National Revenue to make a great deal more information available about applicants for registration, registered charities and formerly registered charities.

see BUDGET p. 12

## Income Tax Act changes and charities

By Terrance S. Carter and Theresa L.M. Mann

On February 27, the federal Department of Finance released pro-

defines the "eligible amount of a gift" to be the amount by which the fair market value ("FMV") of the gift exceeds the amount of any advantage received. This

in the Feb. Amendments without further changes.

While the new definition of gift is necessary to permit splitting, it is problematic from

## Estate assets not a resulting trust

By John Jaffey

Toronto

Property law considers transferred to another without con-

the Manitoba Court of Appeal held: "When property is transferred to another without con-

## WILLS, ESTATES, TRUSTS &amp; CHARITIES

## March federal budget affects charities' disbursement quota rules

## BUDGET

—continued from page 9—

Financial statements, information about a notice of objection, any information in support of any application for special status or exemption under the *Income Tax Act* and the identification of any registered charity in which a sanction has been imposed (with details). Will become available with respect to information dealing with years after 2004. For unsuccessful registration applications, sanitized versions of the application package and the notice of denial

will also be made available.

**Disbursement Quota Rules**  
In addition to the changes designed to implement the 2003 Joint Regulatory Table Report, a number of changes have been proposed to the disbursement quota. Essentially, the disbursement quota is a requirement that a registered charity which is a charitable organization spend 80% of official donation receipts issued in the previous year while a charitable foundation is required to spend the sum of 80% of charitable dona-

tion receipts issued in the previous year and 4.5% in investment assets. Particularly in the context of charitable foundations, a 4.5% return has been quite difficult to obtain, on endowment funds in recent years. As a result, the budget proposes to reduce the 4.5% rate to 3.5%. This change, effective for fiscal periods starting after March 22, 2004, is a welcome change. However, a change that may be less welcome is that the 3.5% disbursement quota will apply to new charitable organiza-

tions immediately and to existing charitable organizations after 2003. One way in which a registered charity could avoid the 80% disbursement quota in order to build an endowment was to require that donors impose a condition requiring that the capital of the gift be held for at least 10 years. The Canada Revenue Agency had interpreted this to only permit income to be spent by the registered charity (but not realized capital gains).

The budget clarifies that it will be possible in future fiscal periods of a charity for it, subject to the terms of any trust conditions imposing 10 year conditions, to apply realized capital gains to meeting the disbursement quota. The budget also contains a number of more technical provisions designed to correct faults in the disbursement quota calculation mechanism dealing with transfers between charities.

Lawyers should review the 2004 budget provisions dealing with charities. These changes represent a substantial change to the applicable rules. In particular, it may well be that the introduction of intermediate sanctions will lead to a dramatic increase in Canada Revenue Agency compliance action.

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